

NEW APPROACHES TO FINANCE LONG-TERM CARE COSTS IN RETIREMENT

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INTRODUCTION

Ideally, our retirement years should be filled with meaningful activities, less stress, and more time with friends and family. But the reality is that approximately 70 percent of people turning 65 today will need long-term care (LTC) before they die, and many of them will need LTC for several years (US Department of Health and Human Services [HHS] 2019). We have known these risks for years, but few Americans are financially prepared for the high cost of LTC, which represents the most significant threat to retirement security (Webb 2020).

Middle-income Americans face the greatest risk. Higher-income individuals can more easily self-fund LTC costs or purchase private LTC insurance, which is generally unaffordable for middle-income individuals. Low-income individuals receive government coverage of LTC expenses through Medicaid. Many middle-income individuals, however, who have insufficient income from retirement savings and Social Security benefits, are forced to spend down their life savings and other assets to qualify for Medicaid benefits (LongTermCare.gov 2021).¹

LTC is expensive, and costs for LTC rise in proportion to the complexity and duration of care. LTC costs

are in addition to medical expenses, which generally are covered by private health insurance policies or Medicare. The median annual cost of LTC is \$105,850 for a nursing home, \$54,912 for a home health aide, and \$51,600 for an assisted living facility (see figure 1) (Genworth 2021). These expenses exceed the median household income of \$47,357 for those over age 65 and median retirement savings (\$144,000) for the same population is largely insufficient to cover the rest (Munnell and Chen 2020). According to the Center for Retirement Research at Boston College, only 26 percent of individuals ages 65–69 can cover severe care needs for at least five years using income, financial assets, and informal (unpaid) caregivers, while 27 percent cannot afford even minimal care needs; the remaining 47 percent of individuals lie somewhere in between those extremes (Belbase, Chen, and Munnell 2021).

LTC costs are already high, but also are rising rapidly. Genworth data show that the cost for facility and in-home care services has increased, on average, from 1.88 percent to 3.80 percent per year since 2004, outpacing the US inflation rate of 1.8 percent (Genworth 2021). The cost of care has grown beyond previous projections as a result of COVID-19, primarily due to labor shortages, the cost of personal protective equipment, regulation, and wage pressures (Genworth 2020).

1. Financial eligibility for Medicaid differs by state, but generally comprises an annual income limit of \$2,382 (in 2021) and a countable asset limit of \$2,000 for individuals. Countable assets generally exclude non-liquid assets. Special rules exist to protect the spouse of an applicant for Medicaid LTC services, depending on the state of residence. Transfers of assets within the five years preceding an individual's application for Medicaid LTC services, known as the look-back period, will disqualify the individual for a penalty period (LongTermCare.gov 2021).

Based on market research and interviews with experts in the field, in 2020 the Milken Institute (Super et al. 2020) analyzed the most significant barriers to meeting the LTC needs of middle-income Americans and identified three promising areas for increased financing and delivery opportunities:

1. Developing better metrics on the effectiveness of technology solutions for home-based care
2. Scaling up promising integrated-care delivery programs
3. Designing complementary and affordable public and private LTC insurance solutions

This essay expands on the third area to identify new approaches to finance LTC expenses in retirement, and proposes several solutions to expand access to insurance to lower the risk of LTC costs in retirement.

LONG-TERM CARE NEEDS OF AN AGING POPULATION

LTC is the continuum of long-term services and supports that people need when they can no longer perform activities of daily living, or ADLs, independently; ADLs include eating, bathing, and toileting, among others. Most LTC is nonmedical assistance that helps support and maintain a person’s health and quality of life and reduces the need for costly medical services. LTC may be delivered in the home by family members or by paid attendants, or to residents in nursing homes and assisted living facilities. Adult day-care centers and charitable organizations also provide services in the community. Medicare covers medical care in these settings, but it does not pay for a stay in any LTC facilities except for stays following acute care. In general, Medicare does not pay the cost of personal care services.

LTC expenses can be exceptionally burdensome for people living with dementia and their caregivers. As the disease progresses, people with Alzheimer’s disease and related dementias often need round-the-clock care at home or in nursing homes and memory care facilities. During the later stages of dementia, a person might live in a nursing home for three to four years, or even longer, depending on the severity of their symptoms. Nearly 75 percent of people age 80 or older with dementia live in a nursing home, compared with only 4 percent of those without dementia (Super, Ahuja, and Proff 2019). The Milken Institute projects that, over the next 20 years,

FIGURE 1: Median Annual Costs of Long-Term Care, US, 2020

Home Health Care	
Homemaker Services	\$53,772
Homemaker Health Aide	\$54,912
Adult Day Health Care	
Adult Day Health Care	\$19,236
Assisted Living Facility	
Private, One Bedroom	\$51,600
Nursing Home Care	
Semi-Private Room	\$93,072
Private Room	\$105,852

Source: “Cost of Care Survey,” Genworth, 2020

the number of those living with Alzheimer’s disease or other dementias in the United States will nearly double from 7.2 million to 13 million (Super, Ahuja, and Proff 2019, 2).

The LTC risk is particularly acute for some demographic groups. For example, the median wealth of Black and Hispanic households is about one-eighth that of White households due to lifelong income and intergenerational wealth transfer disparities (Bhutta et al. 2020). Financial challenges also impact health over the lifespan, due to poorer living standards and inadequate access to health care, nutritious food, physical activity opportunities, and safe housing.

Women face a greater LTC risk to retirement security than men. Women have longer life expectancies, a larger need for LTC, and fewer retirement savings to cover LTC costs. Women also typically need care for a more extended period (3.7 years) than men (2.2 years) (LongTermCare.gov 2020). Because heterosexual married women, on average, outlive their spouses, they often provide LTC assistance to husbands but will be widowed by the time they themselves need LTC. Women are also less likely than men to remarry after divorce or the death of a spouse and therefore live alone as they age (Stepler 2016). As a result, many women either have to rely on non-spousal family members or pay for LTC out of their own pockets. Despite their greater risk of needing to pay for LTC, women are less likely than men to own LTC insurance (US Department of the Treasury [Treasury] 2020).

The need for LTC affects the retirement security of family members as well. Older individuals with no means to pay for their LTC depend on adult children and other family members (overwhelmingly women) for assistance (National Alliance for Caregiving and AARP 2020). Family caregivers often neglect their own health to care for loved ones, and thereby increase their own LTC risk. In addition, many family caregivers, especially those that are women, forgo promotions or even quit their jobs entirely to provide care for a parent or spouse (Transamerica Institute 2017). While they may do so willingly, they often fail to consider that they are putting their own financial and retirement security at risk. As a result, they will, in turn, need to rely on their own children for care, if they are parents, thereby perpetuating the risk of retirement impoverishment due to LTC expenses.

PLANNING FOR THE COST OF LONG-TERM CARE NEEDS IN RETIREMENT IS INADEQUATE

Despite the likelihood of incurring the high cost of LTC in retirement, fewer than 40 percent of workers and 34 percent of retirees are reserving funds for LTC and medical expenses (Employee Benefit Research Institute and Greenwald Research 2021). Even fewer (11.4 percent) of those age 60 and over have taken action to protect against LTC expenses more fully by purchasing LTC insurance (Treasury 2020).

There are several reasons for this discrepancy:

1. There is a mistaken belief that LTC expenses are covered by Medicare or private health insurance (Geber 2021).
2. There is underestimation of the risk. Prior generations typically relied on family and friends to provide LTC. But changes in family size, composition, and location have put increasing strains on these relationships. In 2010 there were just over seven potential family caregivers for every person age 80 and older. By 2030 this ratio is expected to be reduced to just over four to one (Reinhard et al. 2019).
3. Some individuals are ineligible for LTC insurance due to existing disease or chronic health conditions. The experience of LTC costs related to

the pandemic has further increased the attention insurers give to underwriting criteria for an LTC insurance policy (Long Term Care Associates n.d.).

4. The premiums for traditional stand-alone LTC insurance policies can be unaffordable for those who need it most. For example, the average premium for initial benefits worth \$165,000 (growing 1 percent to 5 percent per year) for a healthy 55-year-old man might cost \$1,375 to \$3,685 per year. Premiums vary depending on age, health, location, and other criteria (American Association for LTC Insurance [AALTCI] 2021b). One study found that more than one-third of individuals with LTC insurance at age 65 lapsed their policies prior to accessing the policy benefits for a variety of reasons, including unaffordability (Hou, Sun, and Webb 2015). In addition, reports of premium increases during the life of the policy have caused others to shy away from LTC insurance (Brown, Goda, and McGarry 2011).

RISING COST OF LONG-TERM CARE INSURANCE

The rising cost of LTC insurance results from the mounting cost of long-term services and supports, the increased number of individuals needing care for longer periods, and the shrinking number of LTC insurance providers. The number of LTC insurers dwindled from more than 100 in 2004 to about a dozen in 2020 (Center for Insurance Policy and Research 2021), due to poor financial performance of in-force policies and difficulty in obtaining regulatory approval for premium rate increases to stave off future losses on these policies, as well as difficulty in accurately underwriting and pricing new policies.

When the first LTC insurance policies were created in the late 1970s, the LTC options covered by the policies were limited and there was no actuarial data on which to rely (Cohen, Kaur, and Darnell 2013). Since that time, LTC has been offered in a variety of settings, and the need for and cost of care has increased dramatically. As a result of incorrect predictions regarding cost of care and other inaccurate assumptions in the absence of actuarial data, historically LTC insurers have not adequately priced the policies. Morbidity rates (i.e., percentage of policyholders needing LTC and for a prescribed period of time) have been higher than assumed, due in part

to lower-than-expected policyholder lapse rates (i.e., percentage of policies discontinued by policyholders prior to submitting benefit claims) and lower-than-predicted interest rates (i.e., impact of earnings on invested premiums). The process of seeking regulatory approval for premium increases on in-force policies to stave off further insurer losses and insolvency has been slow and uncertain (Treasury 2020). More recently, however, there has been a significant effort to improve the regulatory process for LTC insurance rate setting and premium increase approvals.² Policyholders who cannot afford the increased premium increases that have been approved have had to decide whether to withhold future payments and let the policy lapse or to agree to benefit reductions.

NEW PRIVATE-SECTOR OPTIONS TO COVER THE LONG-TERM CARE RISK TO RETIREMENT SECURITY

To provide consumers with other options beyond LTC insurance to address the LTC risk, insurers have developed different solutions.

Short-term insurance policies provide LTC benefits for one year or less, with reduced premiums to match. While these policies do not reduce the risk of exhausting a person's retirement savings caused by multiyear LTC needs, they help by covering the immediate costs and typically have no, or less-restrictive, underwriting requirements (AALTCI 2022).

Hybrid products, also known as linked benefit or combo products, combine LTC benefits with life insurance or an annuity, and are another option for protection against the risk of LTC costs to retirement security. Hybrid products gained popularity in 2010 when the LTC insurance portion of the product became eligible for the same tax incentives provided to stand-alone LTC insurance policies (Pension Protection Act of 2006).

HYBRID LONG-TERM CARE PRODUCTS

Hybrid LTC products take one of two forms. First, hybrid life insurance policies couple LTC coverage with a life insurance death benefit, typically by attaching

an LTC rider to a life insurance policy. Benefits paid from the policy to cover LTC expenses will reduce the death benefit; the policy often provides for a minimum death benefit, however, even if the benefits paid for LTC expenses exhaust the allowed LTC benefit.

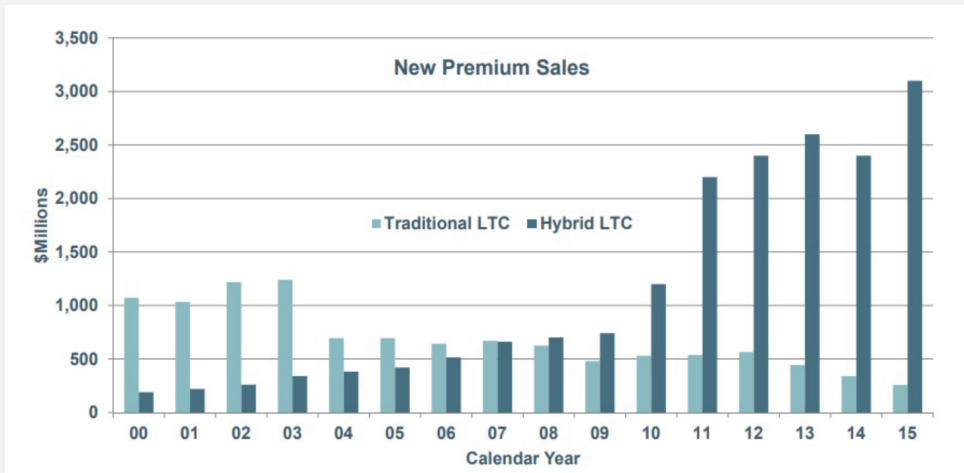
Second, LTC annuities are deferred annuities with an LTC rider. An LTC rider can be added to a fixed, variable, or indexed annuity, each of which carries distinct pricing and benefits such as guaranteed rate of return, inflation protection, and opportunity for higher returns with market performance. Like traditional deferred annuities, LTC annuities are funded with an up-front premium. LTC benefits are tax free and paid according to a formula establishing the monthly benefit available for LTC expenses based on the age at which the benefits commence and up to a predetermined length of time. If the annuitant does not need any LTC, then the annuity value grows tax-free and is taxed when distributed. An LTC annuity will typically double or triple the insured's investment if paid out as LTC benefits. For example, a \$100,000 investment in an LTC annuity would provide \$200,000 or \$300,000 of LTC benefits (Lankford 2010). Because the annuity does not provide a death benefit, underwriting for an LTC annuity is usually simpler than an LTC life insurance policy.

Hybrid products address many of the concerns that individuals have with traditional LTC insurance policies. Hybrid products are not subject to premium increases and provide a return of premium or principal through either death or living benefits if LTC benefits are not needed. Stand-alone LTC insurance, by comparison, is subject to price increases, remains in force only as long as premiums are paid, and has no cash value that could be accessed if LTC benefits are not needed. Because the premiums for hybrid products are paid up front, the coverage is guaranteed, and the owner of the hybrid product does not have to worry about the risk of forfeiting the benefits if premiums are not paid—a likely event for those who have dementia or are experiencing cognitive decline in the normal course of aging.³ Finally, hybrid products are generally subject to less-restrictive underwriting requirements since the benefits provided are subject to stated limits, and are in addition to other benefits provided by the hybrid product.

2. In 2019 the National Association of Insurance Commissioners (NAIC) established a Long-Term Care Insurance Task Force to increase coordination and consistency of rate increase review and approval processes, among other matters (NAIC 2022).

3. LTC policyholders with cognitive impairment are 3.4 percent more likely to lapse their policy (Hou, Sun, and Webb 2015).

FIGURE 2: Long-Term Care Insurance Market Transformation - 2000 to 2015



Sources: 2001-2014 Broker World Surveys and LIMRAs LTC and Individual Life Combo Products Annual Reviews

Choosing between a life insurance product with an LTC rider and an LTC annuity can be confusing because the products differ from each other in their basic structure and features; as a result, additional consumer education is warranted. Hybrid products are also more expensive than stand-alone LTC insurance, and their LTC benefits are generally more limited than those provided by a stand-alone LTC insurance policy (AALTCI 2021b). However, hybrid products have increased in popularity and now exceed the sales of stand-alone LTC insurance policies (see figure 2) (AALTCI 2021a). Hybrid products are less risky than stand-alone LTC insurance policies from the insurer’s standpoint, and therefore there is less chance of insurers exiting the market. According to a 2017 survey, claims and other actuarial results of hybrid products have been positive (Friedrich et al. 2019).

DEFERRED ANNUITIES

Deferred annuities (fixed, variable, or indexed), also known as longevity insurance, offer another means to ensure funds will be available at a future time to cover LTC. A deferred annuity is purchased with a single premium in return for a guaranteed lump sum or monthly payments starting at a predetermined future time, such as the age of life expectancy, irrespective of the annuity holders’ need for LTC or the amount of LTC expenses. Deferred annuities are less expensive than immediate annuities because they have a longer

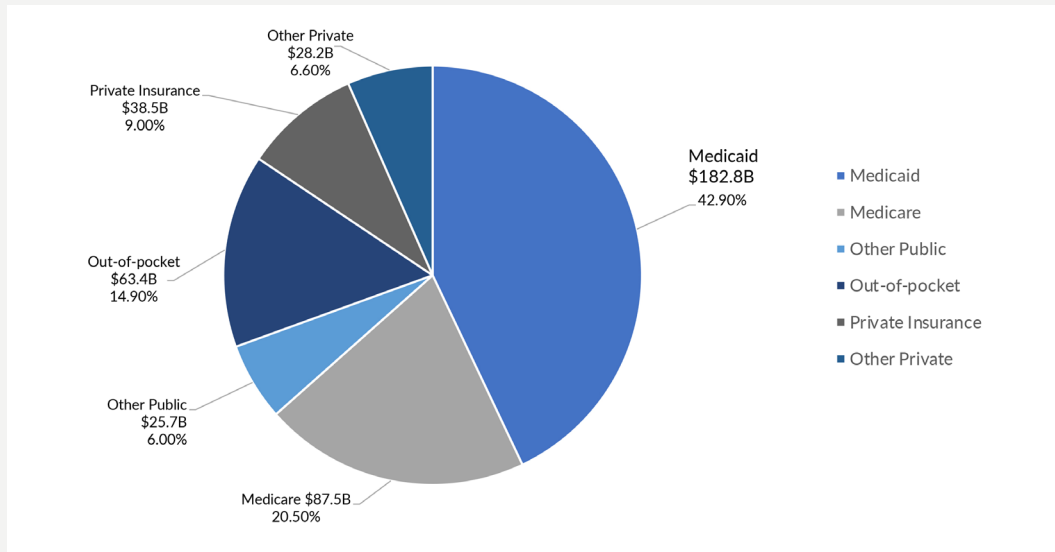
accumulation period and are not linked to LTC expenses incurred. In addition, Medicaid spousal protection rules favor annuitized wealth over unannuitized wealth (Webb 2020).

PUBLIC-SECTOR ATTEMPTS TO ADDRESS LONG-TERM COSTS

Over the past several years, federal and state policymakers have tried to address the LTC financing challenge without much success. LTC expenses represent a growing share of both federal and state budgets. The Medicaid program, funded by federal and state governments, is the largest payer for LTC in the United States. As seen in figure 3, LTC benefits account for 42 percent of total Medicaid expenditures (HHS 2018). These expenses are anticipated to rise dramatically as the number of older adults increases, unless new solutions are found.

Federal efforts to address LTC financing include the creation of tax incentives for LTC insurance in 1996 to the launch of a major federal LTC benefit in 2010. The Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) created the federal Community Living Assistance Services and Supports (CLASS) plan, a voluntary, publicly administered federal LTC insurance program. The voluntary nature of the CLASS Act, along with benefit and funding levels, were deemed to be

FIGURE 3: Who Pays for Long-Term Services and Supports?



Source: "Who Pays for Long-Term Services and Supports?," Congressional Research Service, 2021

actuarially unsustainable. Congress ultimately repealed the CLASS Act before it was implemented.

States have taken a variety of approaches to lower the costs of providing LTC. State LTC insurance partnership programs, for example, represent a partnership between state Medicaid programs and the private insurance industry. These partnerships allow individuals who purchase qualified LTC insurance policies to access Medicaid benefits without spending down their assets to Medicaid levels, if and when their LTC insurance benefits are exhausted. As of 2014, approximately 45 states had implemented LTC partnership programs (AALTCI 2014). While LTC partnership programs have generally succeeded in reducing the use of Medicaid funds for LTC in many states (National Conference of State Legislatures 2005), such programs have largely fallen out of favor due to the lack of availability of LTC insurance policies that qualify for the program. In addition, the incentives provided by these programs have not generally overcome the cost and other consumer concerns about purchasing LTC insurance; in addition, the reporting and regulatory requirements of these programs have dissuaded many LTC insurers from participating (Greenhalgh-Stanley 2010).

In April 2021 Washington State became the first state in the country to adopt a mandatory public, state-run LTC

fund for eligible residents (wacaresfund.wa.gov). The WA Cares Fund would provide a limited LTC benefit funded by a mandatory payroll tax on employees in the state. Workers who either have their own private LTC insurance or who are otherwise eligible for an exemption would be able to opt out of the mandatory tax. In December 2021 Washington State’s governor, Jay Inslee, officially delayed implementation of the WA Cares Fund pending legislative action to address concerns with the program. The constitutionality and actuarial soundness of the program, as well as workers’ struggles to obtain private LTC insurance to qualify for an exemption, are among the many concerns that have been raised in court (*Pacific Bells et al. v Jay Inslee*) and through the legislature. The problems plaguing the WA Cares Fund will likely impact efforts in California and other states to implement similar programs.

Another state LTC program is being considered in Minnesota: the LifeStage protection product, which is catastrophic LTC insurance program through which term life insurance would be converted to LTC insurance upon the policyholder’s retirement (O’Leary Marketing Associates 2018). However, as of this writing the program is still in the conception stage due to regulatory obstacles and lack of provider interest.

NEW SOLUTIONS

Employers, financial advisors, and policymakers, among others, all have a role in addressing the growing LTC threat to the retirement security for millions of Americans. Following is further insight into each of those roles, as well as recommended actions that employers, financial advisors, and the government should consider.

EMPLOYERS

Employers understand the value of workplace health insurance, retirement savings, and other benefit programs to help attract and retain employees. Employers have also increasingly recognized the impact that financial stress has on worker productivity and look to enhance existing benefits and consider new programs to reduce worker financial stress. One way that employers do this is by helping workers achieve financial and retirement security, such as by adding annuity options to retirement savings plans to help workers manage their savings to last their life in retirement. Employers are uniquely prepared to help their workers manage LTC risk in retirement. LTC insurance benefits or plans offered on a group or aggregated basis in the workforce generally are less expensive (due largely to reduced or no marketing and sales costs) than policies purchased on a retail basis. Employer-based plans are also typically accompanied by consumer education about the financial risk of LTC expenses to retirement security. Yet, fewer than one-third of employers offer LTC insurance to their employees (Society for Human Resource Management 2018), despite surveys suggesting that more than half of all workers would be more inclined to purchase LTC insurance if their employers offered it (AHIP 2017).

To reduce workers' financial stress and to better prepare them for retirement, employers can and should do more to help workers manage the LTC care risk to their retirement security by offering one or more of the following:

- LTC insurance or hybrid LTC products, either on a voluntary or a group basis, ideally enrolling employees automatically into the workplace LTC plan

- Health savings accounts as an efficient tool for maximizing savings to pay for LTC needs or LTC insurance premiums
- Deferred annuities as an investment option in workplace retirement plans⁴
- Financial literacy and financial wellness programs to assist employees in understanding their LTC risk, and programs that suggest ways to cover that risk in their retirement financial plan
- Prevention and wellness programs to help reduce the risk of needing LTC through healthy aging activities
- Caregiving support to employees who act as family caregivers

FINANCIAL ADVISORS

Financial advisors are in the business of helping their clients reach their short- and long-term financial goals. This role extends beyond helping their clients grow their retirement savings and maximize their investment earnings, but also to identifying and managing the risks to their clients' financial and retirement security. Given the significant LTC risk to retirement security, financial advisors should help their clients understand and prepare to manage the financial risk of LTC with any of the following steps:

- Discussing the cost and risk of needing LTC and the impact on their client's retirement savings.
- Calculating the LTC risk (Georgetown University n.d.) as part of each person's retirement financial plan and discussing the options of protecting against the risk, such as acquiring private insurance, saving more for retirement, investing in protected income products, or selling down assets to become eligible for LTC services through Medicaid as a last resort.
- Protecting financial assets and managing financial LTC risk in the face of possible cognitive impairment by, among other steps, ensuring powers of attorney and other legal protections are in place. This step should include establishing a dedicated source of funding for LTC insurance to avoid policy lapses due to cognitive impairment, as

4. The Setting Every Community for Retirement Enhancement Act, or SECURE Act, which became law on December 20, 2019, facilitated the offering of annuities in defined contribution plans.

well as considering the purchase of a hybrid LTC product that protects against the risk of forfeiting the benefits if premiums are not paid by requiring premium payment up front.

POLICYMAKERS

Federal and state policymakers have long considered policies to (a) further reform public programs that provide long-term services and supports and funding for LTC expenses to increase those programs' efficiency and availability, (b) incentivize the purchase of LTC insurance and hybrid products by consumers, and (c) provide financial support to family caregivers.

Early in 2021 the Milken Institute released a series of public policy recommendations in its report, "New Approaches to LTC Access for Middle-Income Households"; those new approaches include Medicare expansion programs and technology solutions to better integrate health and LTC (Davis and Servat 2021). A third new approach focuses on developing complementary public-private insurance solutions that offer seamless, affordable coverage. The recommendations were developed as part of a Financial Innovations Lab, which brought together researchers; policymakers; and business, financial, and professional practitioners to create market-based solutions to business and public policy challenges.

To address inadequate LTC insurance options, Financial Innovations Lab participants urged state policymakers to collaborate more directly with the private LTC insurance industry (Davis and Servat 2021). As states consider the concept of publicly funded front-end programs, they should try to align in the areas of eligibility criteria, approved services and supports, and daily expenditure limits with private LTC insurance. Insurers can help avoid gaps in coverage if they treat the public program's depletion of benefits as the elimination period (also known as the qualifying or waiting period) of their policies. If, for example, the public program has a maximum lifetime benefit of \$36,500, the private insurance market could recognize this amount as the elimination period, thereby allowing policyholders to fill gaps in coverage up to a predetermined amount, similar to Medicare supplemental plans. The National Association of Insurance Commissioners should develop state guidelines that ensure public programs and private policies complement each other. Benefit levels should be standardized across states.

The federal Commission on Long-Term Care (2013), the Federal Interagency Task Force on Long-Term Care (Treasury 2020) the Bipartisan Policy Center (Manning 2021), and the Milken Institute (Davis and Servat 2021) have all provided public policy recommendations to address the LTC risk to retirement security, including coordination of the insurance industry with regulators. The recommendations warrant serious consideration by policymakers based on their cost and likely success in mitigating the LTC risk to retirement security, including

- creating a refundable caregiver tax credit to help with out-of-pocket LTC costs;
- providing credits toward Social Security for family caregivers' time spent out of the workforce providing unpaid caregiving (Social Security Caregiver Credit Act of 2021);
- improving the viability of private LTC insurance by standardizing and simplifying benefits to achieve an appropriate balance between coverage and affordability, such as creating catastrophic care policies, high or nondeductible policies, and term life insurance policies that could be converted to LTC insurance or hybrid products at retirement;
- creating a public-private program to cover catastrophic LTC costs that is funded by a payroll tax to help with the cost of LTC (Well-Being Insurance for Seniors to be at Home Act [WISH Act] 2021); and
- permitting limited penalty-free distributions from a qualified workforce retirement savings plan for the purchase of private LTC insurance or hybrid LTC products.

CONCLUSION

The financing of LTC has vexed policymakers, insurers, government administrators, and researchers for decades. The LTC risk to retirement security is significant and is increasing with the growing number of Americans living longer, the rising cost of long-term services and supports, and the decrease in access to traditional private LTC insurance. The time for action is now. The crisis we have been warning about, as 10,000 Americans turn 65 each day, has arrived (Alliance for Lifetime Income n.d.).

Insurers, as well as federal and state policymakers and administrators, are working to provide innovative solutions to help individuals protect against the LTC risk and provide LTC services at a lower cost. Employers and financial professionals also play a critical role in increasing awareness of the risk and educating the public about ways to mitigate the LTC risk to retirement security. Individuals must protect themselves against the risk by including coverage of LTC expenses in their financial and retirement plans and engaging in activities to promote health and prevent chronic conditions. As outlined in this essay, there are several possible solutions that would lessen the LTC risk to retirement security; stakeholders must act quickly to address the current crisis, however.

AUTHOR'S NOTE

The information provided in this essay does not, and is not intended to, constitute financial or tax advice; instead, all information is for general informational purposes only.

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