Pitfalls of Long-Term Care Insurance Products

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When Nancy Nasief was diagnosed with ovarian cancer in 2007, her husband Edmund G. Nasief Jr., a UBS advisor, wasn't thinking about long-term care insurance. It was about the last thing on his mind. In fact, when one of the members of his advisory team, the Nasief Meyer Wealth Management Group in Louisville, Ky., suggested in 2011 that he sell the product, he scoffed at the idea.

Then Nancy took a turn for the worse in 2012, and Nasief hired a caretaker to assist his wife 12 hours a day. "I began to live this problem, emotionally," he says. "Nobody thinks about it; then it's too late."

When she died three months later, the first thing Nasief, 63, did with the proceeds of her life insurance policy was put down a large, one-time payment on a long-term care contract for himself. He bought it with his daughter in mind. "I don't want you to have to go through with me what I went through with mom," he told her.

Fear: It's the primary reason most people buy LTCI. It assuages the fear of going broke paying for elder care, the fear of depleting wealth intended for the next generation, and the fear of saddling family members with the costs and logistics of providing care if assets run out. One look at the stats, and fear, or at least serious concern, seems a legitimate response.

Almost 70% of people aged 65 can expect to eventually require some level of services and support to meet personal care needs over an extended period of time, according to the Centers for Medicare and Medicaid Services. The median cost for a private nursing home is over $80,000 per year, according to a survey from Genworth Financial, one of the oldest and biggest providers of long-term care insurance. That number has risen over 4% annually for the past five years and is expected to go higher with increased demand from baby boomers, says Bonnie Burns, a policy specialist with California Health Advocates, a health care watchdog group.

That's why the cost of providing long-term care is one of the top two concerns among investors with over $250,000 in assets, according to a recent UBS survey. "It's the number one thing that people do not want to talk about and also the number one thing that can blow up their retirement if it's not addressed on the front end," says Kimberly Maez, an Ameriprise private wealth advisor based in Colorado Springs, Colo.

But individual long-term care insurance has not evolved into the security blanket that many advisors and their clients initially hoped it would be. Individual long-term care insurance, and by association, those who recommend it, face some serious challenges, chief among them the financial instability of its providers, which has led to exploding premiums, changing policy terms, increasing qualification standards and the requirement that purchasers predict, decades in advance, how much long-term care they are likely to need.

Highly publicized class-action lawsuits have sprung up around the country as a result of insurers' attempts to stay profitable in the face of economic challenges. Most of these cases seek to block rate increases that often top 80%, others dispute denials of benefits. These issues and the complex nature of the product have caused a sales plateau for individual LTCI in the past two years, as reported by the American Association for Long-Term Care Insurance. Genworth Financial reported that second quarter sales of individual or traditional, premium-based) LTCI dropped from $53 million in the year-ago quarter to $38 million last quarter.

Despite the drop, about seven million individuals, including about 12% of Americans over 65, currently have long-term care coverage, according to a 2012 annual report from the Life Insurance and Market Research Association. Overall, AALTCI reports, providers paid $6.6 billion in benefits in 2012 to a record 264,000 consumers. That money went to disabled policy holders to purchase home care services, assisted living and nursing home care.

But consider this: Two-thirds of those over 65 require less than two years of formal paid long-term care services, according to the SCAN Foundation, a non-profit charity that addresses health care issues for seniors. "This particular service represents [coverage for] a potentially catastrophic risk for a small number of people," the report said.

Today, some are questioning whether traditional individual LTCI is the right answer to the challenges of paying for long-term care. As new, more user-friendly LTCI products enter the marketplace, the answer is increasingly "no."

Long-Term Speed Bumps

Some trace the LTCI industry's problems to its inception—the assumptions baked into the LTCI business model were flawed from the beginning. Carriers did not anticipate how quickly health care and long-term care costs would rise, according to Scott Kipper, insurance commissioner for the state of Nevada. Underwriters also anticipated that 5% to 6% of policy holders would let their plans lapse. In reality, it was closer to 1% to 2%, he says. Last, carriers counted on a much higher rate of return on invested premiums than they have actually experienced, according to Steve Schoonveld, a linked benefit actuary at Lincoln Financial Group, which sells long-term care products. Schoonveld was speaking about the general industry and not from his company's perspective.)

“Long-term care is heavily dependent on a decent interest rate environment to support the structure,” he says. But in our long-standing stagnant rate environment, insurer margins tanked. One provider, the CalPers LTCI that covers state and local government workers in California, projected rates of return of over 7%, according to the SCAN Foundation. That miscalculation resulted in a 32% deficit for CalPers LTCI in 2009.

This story played out so often that over the past 10 years, the number of carriers dropped from over a hundred to around two dozen key players. The ones that remained found themselves underfunded and in need of assets to pay increasing claims. Earlier this year, the Los Angeles Times reported CalPers was increasing its rate by 85%. Major carrier Genworth notified vendors earlier this year that it had requested increases of up to 95% on some of its individual LTCI premiums. Carriers must request rate hikes from each state’s insurance board.) To avoid bankrupting the carriers, states approve increases, although usually less than requested, but the hikes are still staggering.

A 65-year-old client of Nasief’s, who’d purchased a long-term care contract 20 years earlier from a different advisor, recently discovered his premium was doubling. He either had to pay, or he’d receive around half of the previously agreed-to benefits, Nasief says. It put both advisor and client in an uncomfortable position. “Pick your poison,” Nasief says. “What do you do when you are 65 and you thought you were doing good planning when you were 45?”

Those kind of increases have become so common that Maez, who has sold long-term care insurance since 1997, factors in an additional $500 to $1,000 a month to cushion against extra medical expenses like rate hikes. Even with massive hikes, some of the older policies are still cheap because they were so underpriced to begin with—the root of the current industry problems.

But premiums aren’t the only variable for individual LTCI policies. New contracts—and renewed contracts—frequently trim some of the benefits common in earlier plans. For instance, unlimited lifetime benefits, which allow a consumer who pays the premium to utilize long-term care as long as they need it, are no more, Maez says. Now premiums offer coverage for a fixed period and a fixed payout amount, leaving clients to guess how many years of coverage they are likely to need or how much they’re likely to spend on it. They either overpay for too much coverage or risk relying on self-insurance or family members to make up the gap in insurance coverage, Burns says. Clients don’t know which camp they’re in until it’s too late.

“It’s a balancing game,” says Tony Steuer, director of financial preparedness at United Policyholders, a non-profit consumer group. “If you make a mistake and you fall outside the bell curve, and you’re the person who has a 20-year claim, then you’re really up a creek.”

Another challenge for advisors is that insurers are becoming increasingly risk averse. Even clients who previously would have qualified may not today. Maez said she’s had insurers disqualify clients for arthritis, diabetes or a family history of illnesses like multiple sclerosis.

Clients also have to qualify to have their claims reimbursed. They must be incapable of or require assistance with at least two of six daily activities: bathing, dressing, eating, maintaining continence, toileting and transferring from bed to chair. There are also fine print issues that can cause some hang-ups, Burns says. Clients have to be especially careful because the person filing the claim will probably be the adult child of the policy-holder and not familiar with the original plan. These problems could become more frequent as new care facilities, such as those designed specifically for dementia patients, become more common.

That issue is the focus of lawsuits against carriers, such as Pavlov vs. Continental Casualty Co., a 2007 case in which the company was accused of refusing to pay claims on the grounds that the facilities used by plaintiffs were outside the requirements of the original contract. The company eventually settled.

“[Advisors] need to keep in mind that they’re selling a product to someone in their 60s who might not use it for another 20 or 30 years, and long-term care insurance needs change,” says Jeff Goldenberg, an attorney with Goldenberg Schneider who argued for the plaintiffs in the Pavlov case. “The industry is totally different, the facilities are different, so those areas are ripe for battle.”

Image Problems

The industry acknowledges it has an image problem. In response, it’s introducing more products. One, a combination policy, is sold as a life insurance policy that could also be applied toward long-term care costs if that need arises. The remainder is paid out as a death benefit to heirs. As an added benefit, most combination policies, which can be paid for over three, five and 10-year time frames, are guaranteed against rate increases.

Another up-and-coming product, called a single premium modified endowment, allows a medically qualified consumer to put down a lump-sum payment that will ensure care for a set period of time. Nasief, who opted for this policy, put down $150,000, which provides an $8,000 monthly benefit for 72 months. He already used some of his quota when he was bed ridden from hip replacement surgery and hired a caregiver.

If Nasief decided to cancel the contract, he could get a return on his premium. He has found these plans so appealing that as of March of this year, his office has only sold policies with single-pay premiums. Nasief’s client who was facing doubled premiums, for instance, canceled his traditional plan and bought into a single-pay policy. “He was lucky because he’s still insurable,” Nasief says. Otherwise, the client was facing a situation where “you either walk away from your policy or you double down and still run the risk of losing your premium if you don't ever use it. He was quick to embrace the idea."

That's probably why the single premium policies, like Nasief's, accounted for around 24% of the market in 2012, according to LIMRA. Meanwhile, despite stagnant growth in the LTCI industry overall, there has been double digit growth for the combined products. Around 65,000 combination policies were sold in 2012, an increase of 27% from 2011, LIMRA said.

Already, rising markets and demand for the new brand of products has breathed some new life into long-term care insurance providers. Two large players, Thrivent and TransAmerica, returned within the past two years. Kipper says that combination products could be the next major trend in product evolution as the industry matures. The National Association of Insurance Commissioners will be following it closely to ensure proper disclosure and underwriting, he says.

"That's the next place we're going to start looking," Kipper predicts. "There's some concern from regulators that these products are so new that we may not have great information on their pricing."

Better Some Than None

Some advisors have already noticed an unwelcome trend with some of the new types of plans. "We have seen benefit decreases on the hybrid products, so I'm not going to predict what's going to happen," says Dan Schulte, manager of annuities and insurance at Benjamin F. Edwards. "But the bottom line is that having some coverage is better than not having any in place at all."

That's the prevailing sentiment among advisors. Many believe these policies are worthy products that protect clients from future financial and emotional troubles, despite the potential hiccups. It doesn't hurt that these products have traditionally added a nice boost to business.

Traditional long-term care insurance, for which a client would pay monthly premiums, pays out as much as 50% of the first year's premium as a commission to the selling advisor, according to Steuer. For lump-sum policies, advisors and their firms split around 6% of the total premium, according to one advisor.

Advisors also find a lot of value from LTCI because of its ability to enhance relationships with clients. "For most of the advisors my age, we're going to get old with our clients," Nasief says. "There's genuine empathy and concern around that because we're all living this together."

LTCI also gives the advisor other products with which to build out a fee-based practice. At Ameriprise, the majority of advisors are licensed to sell LTC-related products, according to Patrick O'Connell, head of the employee brokerage at Ameriprise. In fact, many of the largest long-term care insurance firms make a majority of sales through advisors.

But because these products can be so confusing, it is crucial for advisors to carefully weigh whether they are appropriate, and if so, which ones are best for a client's needs. First, many clients will not be able to qualify for LTCI, and self-insurance will be the only option. If a client does qualify, advisors must still determine if it's more appropriate to self-insure. For millionaire clients, even those who could easily self-insure, Maez thinks the plans could be a valuable asset protection vehicle. Although the premiums will not be earning income, the ultimate savings may justify the expense, she adds. Consumers should typically spend no more than 7% of their income on long-term care insurance, according to NAIC.)

If clients choose to go with LTCI, due diligence should include research on the insurer's financial strength, its history and the firm's rate increase history to determine if those increases align with general industry trends, O'Connell adds. Regardless of the client's ultimate choice, Maez is mostly concerned that her clients have some kind of long-term care strategy in place.

"You can also talk about ultimately just taking your chances," she says. "You just want not to be in denial about it."