CNNMoney.com

Your toughest retirement puzzle: Long-term care

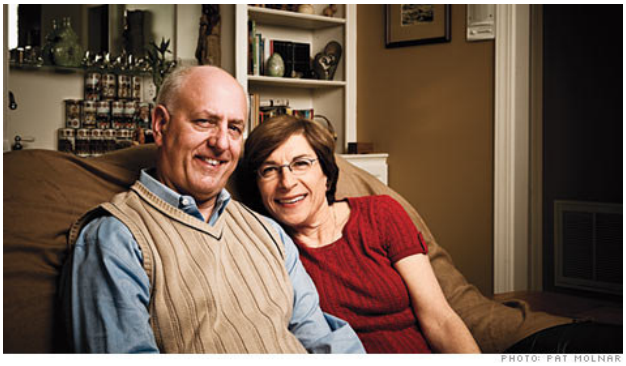

PHOTO: PAT MOLNAR

By Lisa Gibbs, Money Magazine senior writer

April 7, 2010: 9:08 AM ET

(Money Magazine) -- Ask someone why he or she bought a long-term-care insurance policy and you will probably hear a story about family. Often a sad or scary story.

Joyce Smith, 68, saw her mother develop Alzheimer's and go into a nursing home, where she's been for nine years. Her mom's savings are completely drained, and she's on Medicaid, the medical safety net for the poor. Joyce and her husband Harry, 62, were shocked to see how much good care costs, so eight years ago they bought a policy that should pay for all or most of their care should they ever need it.

The price tag: a hefty $6,000 a year.

They'll have to keep paying that premium all through their retirement (or until they collect benefits), even in later years as their assets dwindle. And that's assuming the rate stays where it is today. "We've already put over $40,000 into it," says Harry, but it's brought them peace of mind. "We're not sorry," he adds.

The high cost of insurance is one of the challenges anyone faces in thinking about how to pay for long-term care. The risk that you will need nursing-home care or a home health aide is certainly real. About 70% of seniors eventually need help, and nursing homes (the most intensive kind of care) can cost $200 to $300 or more a day.

But that also means long-term-care premiums are high enough to take a substantial bite out of your retirement savings. And the policies can be confusing, with countless combinations of options, limitations, and premiums to cover services you may not need for 20 to 30 years.

As you'll see, for many people, insuring for long-term care doesn't make sense. But whether or not you buy coverage, long-term care is a crucial part of your overall retirement strategy.

CNNMoney.com

The subject is a sensitive one: This is, after all, a time when you'll be dependent on others for help with basic tasks like eating or getting in and out of bed. That causes some people to avoid thinking about the problem until it's too late. For others, imagining such vulnerability can cause them to buy more insurance than is practical.

The best approach: Turn down the emotional temperature of the decision. On the following pages you'll get jargon-free (and scare-tactic-free) answers to 11 important questions about the toughest dilemma you'll face in planning for retirement.

How likely is it that I'll need expensive care?

Wrenching stories like that of Joyce Smith's mom are just one end of the spectrum. Most care happens outside costly nursing homes -- people get help from family, hire home aides, use adult day-care centers, or move into apartments in assisted-living facilities. It all adds up to a financial risk worth planning for but not panicking over. Some have more to worry about than others.

"Long-term-care insurance is a much better buy for women," says Howard Gleckman of the Urban Institute, because they tend to outlive their husbands. People like Smith with a family history of Alzheimer's are at greater risk because that and other forms of dementia are more likely to lead to long stays in a home.

If I decide not to buy insurance, how would my care be paid for?

Out of your pocket, for as long as the money is there.

Medicare won't cover most long-term care. (It will pay for a limited time if you are recovering from an event like surgery or a stroke.) Instead you'll pay until your assets are low enough for you to qualify for Medicaid. As an individual, you have to be down to your last $2,000, not counting the house and a few other assets.

Spouses can usually hang on to only half of their joint assets up to about $110,000. (Rules vary a bit by state.) Some people shift assets to their children to get onto Medicaid faster while keeping money in the family, but new laws have made that harder. The government now does a "look back" at assets transferred in the previous five years and will delay your Medicaid eligibility for nursing-home care accordingly.

For those whose chief concern is simply getting quality care, ending up on Medicaid isn't the worst outcome -- but you want to put it off for as long as possible.

A nursing home that takes Medicaid won't

kick you out when you switch, but since the program pays less than private rates, a good facility might not let you in the door unless you show you can pay for at least some of your care yourself. (Some expensive facilities don't accept Medicaid at all and Medicaid generally won't get you a private room.) Depending on your state, it's also more difficult to get home-based care or assisted living via Medicaid.

Having more money, from whatever source, means more options. So at the very least you'll need significant savings to act as a buffer between you and the Medicaid safety net. Michigan college professor Paul Freddolino, 63, and his wife Donna, 52, an educational trainer, opted not to buy insurance. Instead they plan to set aside $75,000 of their savings as a "long-term-care account."

They' re taking a calculated risk, but should that money run out, they have other assets they can tap. "You don't know what the future is going to bring, but this just makes sense for us," says Donna.

Who needs insurance most?

Insurance adds an even bigger buffer, which can be emotionally reassuring for people without kids who can help. But for many purchasers the point is less to guarantee care than it is to preserve assets to pass on, or to protect a spouse's lifestyle.

Financial planner Brian Smith echoes many other advisers when he says to look into a p olicy if you have assets of at least $250,000, not including your home, to protect.

Is the insurance affordable?

This is the deal breaker. If you aren't yet sure you'll have enough money to fund even a healthy retirement, long-term-care insurance isn't a cost you can carry.

For a couple in their mid-fifties, coverage can easily cost from $2,000 to $6,000 a year, depending on the benefit they choose. If you find you can't afford your premium, you'll lose your coverage unless you paid extra for a "non-forfeiture" benefit.

The National Association of Insurance Commissioners recommends you spend no more than 7% of your income -- including the income you'll have in retirement -- in premiums. When you do the math, leave wiggle room: Your premium is likely to rise, perhaps by 10% or more every 10 years. Insurers can't single you out, but they can raise rates for everyone in your class of policy.

When should I buy?

It's a complicated tradeoff, but the sweet

spot is in your late fifties. The longer you wait, the higher your premium will be: A lifetime Genworth policy that costs a 55-year-old couple $4,800 would cost $6,400 for 60-year-olds.

Your risk of being turned down also goes up as you age. In your fifties, you have a 1-in-7 chance of not qualifying, says the American Association for Long-Term Care Insurance, a trade group. In your sixties there's a 1-in-4 chance.

Why not buy as early as possible? A lot can change over the life of a contract: the insurer's financial health, its premiums, your financial position, and even the technology used to deliver care, which could make it cheaper or more expensive. Buying early extends the uncertainty. Also, in your early fifties you may have more pressing priorities, such as college tuitions and building up your nest egg.

Would health-care reform change any of this?

In mid-March, the health-care bill was still alive, and legislation included a voluntary, public long-term-care insurance plan. If you are near 60 or older, this probably wouldn't change your decision, says Gleckman of the Urban Institute.

The coverage would be partial, and the premiums might not be a better deal. Also, you'd have to pay in for five years before benefits kicked in. For those in their early and mid-fifties, though, reform that includes long-term care would be another reason to wait a bit to see how the market develops.

What must my policy cover?

Long-term-care insurance isn't like health insurance. Instead of covering a portion of whatever care you need, it pays you up to whatever benefit level you choose in advance, and not a nickel more. So pick your number carefully.

Most policies are written in terms of maximum daily benefits -- say, $200 -- for a set number of years. (Benefits are triggered when you can no longer perform two "activities of daily living" or become cognitively impaired.) You should base your daily benefit on the cost of care where you plan to retire -- or where your kids live, if you think you might move near them should you become ill.

At a minimum, make sure that the policy can be applied not just to nursing homes but also to licensed home care and assisted living, and that it includes an "alternative p lan of care" provision. That last item gives you wiggle room in case medical advances change how long-term care is delivered.

Some policies will let you pay anybody

including friends or neighbors -- as long as they're not family -- for informal home care.

Do I need inflation protection?

Absolutely, even though it's expensive.

Most analysts of the long-term-care industry expect costs to rise significantly in the coming years. Unfortunately, plans don't offer a benefit that rises with an index of nursing-home costs -- instead you have to choose an annual rate of growth for your benefit. It's guesswork, but most plans are pegged to a 5% rate.

That's a good baseline, since prices at assisted-living facilities and other care centers have increased a bit over 4% a year since 1996. But be mindful of a peculiar industry practice: You can sometimes choose a "simple" or "compounded" growth rate. Compounded is how you usually think of a growth rate, and it's how inflation works.

As you can see in the chart titled "Make the Best Call," a simple 5% means a smaller benefit. It will also have a lower premium, but for younger applicants that could be a dangerous tradeoff, since there's more time for inflation to do its damage.

How long should my coverage last?

If you're forced to choose between flexible benefits and the length of coverage, trim back length before cutting key options like inflation protection and home care. Also, a plan that covers three years can actually last longer: Exhausting even a three-year policy is pretty uncommon.

That's because if you start care at home or in an assisted-living facility, you're likely to be spending less than your maximum daily benefit. The extra money goes into a pool for use later, extending the amount of time you're covered. Another time tradeoff you might consider is to extend your "elimination period" up to 90 days. That's the period at the start of your care when you aren't covered.

A "partnership" plan is a good idea if it's offered in your state. After you exhaust your benefits, you'll be allowed to go on Medicaid while keeping more of your assets.

What should I know about the insurer?

Some holders of older policies have been socked with enormous rate increases or have complained of hassles getting claims paid. This is even more likely with financially weaker firms that priced their products too low early on in an effort to get market share. So buy only from insurers with a strong financial rating.

Maryland insurance broker Connie Golleher also looks for companies with decades of

experience in long-term care. "That says to me they are committed to the product and have a history of claims experience," she says. Finally, check complaint records with your insurance regulator; start at naic.org to get to your state's site.

My agent wants to tack long-term care onto my life insurance or annuity. Does that make sense?

Probably not. One exception: If your health precludes you from qualifying for long-term-care insurance, some annuity "hybrid" policies have less extensive medical underwriting. But when combining two kinds of coverage in one policy, it's often harder to compare costs and get the best prices.

Insurers target hybrid policies to people who hate the idea of paying a premium and perhaps getting nothing back. But if that happens, says Dallas financial planner Erin Botsford, "call yourself healthy and lucky."

Beth Braverman contributed to this article.

How do you plan to spend your tax refund? Tell us about it and you could be included in an upcoming story on CNNMoney.com. For the CNNMoney.com Comment Policy, click here.