Using The Life Insurance Death Benefit To Resolve The Long-Term Care Financing Dilemma

Enhanced use of existing products like retirement accounts and life insurance may be one of the most promising avenues to cover the cost of long term services and supports (LTSS), also known as long-term care. As with many solutions to the financing conundrum, however, a private sector approach to funding long-term care needs government involvement. Currently most people turn to Medicaid for their LTSS needs, but we propose it would be better to construct a true catastrophic backstop for all Americans.

We propose a catastrophic, shared stop-loss program that would provide LTSS for a majority of people by creating a better back-end protection and allowing participants to tap into the death benefit found in life insurance before accessing Medicare and Medicaid, thereby extending private coverage longer than current mechanisms. We call this Dual Purpose Insurance because it acts as either coverage for long-term care needs or purely as a death benefit.

A universal catastrophic backstop would combine public and private interests and would replace Medicaid, while working more efficiently with the private market. While any number of private sector products, such as retirement funds could be tapped, we explore the use of life insurance death benefits to show how this realignment would work.

Catastrophic Coverage For LTSS

One does not need to build much of a case that there is an immediate and increasing need for society to protect against the costs of long-term services and support. Current private sector solutions have not resolved the problem, and while Medicaid has become the last resort for LTSS coverage, everyone recognizes the program is not structured well for this.

Several recent reports suggest a different option. The Bipartisan Policy Center supports a catastrophic insurance program for Americans aged 65 and older. The Long-Term Care Financing Collaborative also supported a government role in expanding protection against catastrophic risk in long-term care financing.

Catastrophic coverage plans are not a new concept for government. The concept already exists in Medicaid. As compared to the means tested model found in Medicaid however, the new models for a catastrophic program reorganize how risk is structured.

Many groups have offered proposals for how a catastrophic plan would work. To us, the essence of these proposals is that:

-Americans would have clarity about their personal liability for LTSS expenses, which they need to cover on the front end. Most proposals suggest the catastrophic backstop starts after a person has spent their own money or insurance for the first two or three years and protects assets, not high-income people.

-The private insurance market (broadly conceived) is encouraged to expand their products and options to help Americans finance front-end LTSS expenses

-State Medicaid programs would still cover the poorest individuals, as they do now, who cannot afford private insurance or similar options (for instance home equity) for front-end coverage.

-The program would operate as Medicaid does today, with an income test so the well-off are not subsidized.

With this new partnership between individuals, insurers and the government (which financially acts as a reinsurance entity) we bring more private dollars into play and replace Medicaid for this cohort. It's up to policymakers whether a new Medicare Part E is created or some other new program to deliver the benefit, though adding this to Medicare would make sense in the abstract since the Centers for Medicare and Medicaid Services are already structured to run large programs of this nature.

Until such catastrophic coverage is created we have to consider options to protect individuals now. A model does exist for this, in conjunction with Medicaid: the New York State Partnership for Long-Term Care. The idea behind the program, instituted in 1989, was that one could substitute long-term care insurance for Medicaid. In the typical model a person has dollar-for-dollar credit. That means if they buy $100,000 worth of long-term care insurance then they don't have to spend down to Medicaid's required minimum in assets (which is generally $2000) but rather have $102,000 as their floor. The income test usually employed by states is not waived, however, so a person who might run through their private insurance might still not qualify for Medicaid because they have too much income. The savings in New York are quite substantial –$34 million for Medicaid in 2014 alone – and only 440 beneficiaries (out of over 104,000 policies sold) have tapped Medicaid after running through their insurance.

The partnership concept is authorized in over 40 states covering over 90 percent of the US population. So while these are not set up quite like the New York partnership, the concept of combining long term care insurance and Medicaid is well established across the country.

Tapping Into Life Insurance Death Benefits

In addition to catastrophic coverage to protect individuals from high long-term care costs, individuals must be protected on the front end. One of the critical issues not often discussed is that even the best products and solutions have to get into the hands of the consumers to make a difference. Some products jump off the shelf -- not so with long-term care coverage.

Life insurance is extensive: the number of individuals with life insurance coverage is 70 percent. The average face value of life insurance is $130,000. Fully 55 percent of life insurance plans are permanent or whole life; the rest are term life insurance, which pays a benefit only during a specified term, and is typically provided through an employer.

Life insurance already can -- to some extent -- be re-purposed for long-term care needs via two pathways. But neither is fully utilized. One is acceleration: when an individual meets the long-term care insurance trigger for failure in being able to do activities of daily living (ADLs) such as bathing or toileting, or cognitive impairment, the life policy can be accessed prior to death. The other mechanism is viatication: the policyholder simply sells the policy to a third party and collects the money before death. Both of these have costs and legal restrictions that limit their utility. In addition, with viaticals, one can argue the insurer loses control over the policy to an outside vendor that is betting against them on the life and death of the insured.

In addition, a person can access the death benefit via a loan, but only for the cash value. We propose accessing the whole death benefit (minus the discount for present value).

In order to use existing private sector products for LTSS financing, the benefit should add little or no extra cost. For instance, it would require passive leverage of the death benefit in all life insurance products, meaning there would be no additional costs for consumers to trigger the policy for long-term care rather than death insurance. The cost of using the death benefit for long-term care insurance instead of life insurance would be decided when (and if) the policyholder needed it, rather than at time of purchase. These transaction and lost opportunity costs would be deducted from the death benefit at the time the policyholders trigger it.

We need to act now to make this available to Baby Boomers. Most other proposals require the sale of a product, often to persons who are younger so the product's value has time to grow. While this helps future generations, if we want to protect seniors today we must re-purpose existing products. (Most other life insurance-based proposals apply only to new sales, and with additional cost.) Acting now also helps younger people and new buyers, who also will gain protection against long-term care costs.

There should be no adverse selection because life insurance includes everyone with no need to be tested for good health. (If underwriting had been required, the individual passed this at the time of purchase of the life insurance policy.) Long-term care insurance, on the other hand, excluded people with disabilities.

Dual Purpose Insurance would not require new taxes and, the savings to Medicaid would, in our opinion, exceed any of the costs associated with creating this product.

How Do We Get There?

Discussions between state regulatory authorities and the life insurance industry should take place to identify how we can repurpose current insurance policies for this use. Given that there are certain lapse assumptions – that some "x" percent of policyholders will drop coverage and therefore not become a claimant -- in life insurance (as there are in long-term care insurance), there is a cost consequence to the insurer to pay out for long-term care claims and not a death benefit. The insurer cannot give the full value of the death benefit to the consumer. But we believe actuarial analysis will show the discount for paying out early is minor, say in the 10-20 percent range. (These kinds of analyses have already been done for accelerated life products.) Thus, a person with that average $130,000 life policy should be able to use over $100,000 for long-term care.

Absent a government mandate to buy the product, the best way – and the current method – of delivery is through the employer. For new sales, we envision that in the employer (group) market there would be automatic (passive) enrollment. This is usually done anyway since we are talking about a minimal term life insurance product. This adds no new burden to employers. Employers could also purchase tax-qualified insurance in place of traditional term insurance, which generally offers a death benefit equal to one year's salary (at no extra cost to employer). Today, at least $50,000 of employee term life insurance is tax-qualified for employers. That amount is sufficient coverage for more than half the individuals that will need some long-term care.

But to truly reach all Americans we also need a robust individual market. These same products would be offered by companies and agents just as other life and annuity products are now. We believe those looking toward retirement will be particularly interested: When the need for life insurance wanes, the need for long-term care insurance increases. But this insurance is a consumer choice, with no mandate they buy. We believe insurance companies are interested in developing and providing pay-out products for older consumers and this offers a new way to reach them. With Dual Purpose Insurance flexibility every option can be covered: individual situations, regional long-term care needs, and so forth.

We support a vigorous private insurance market. But we can do better for our citizens. The first step is catastrophic coverage and the second part is a robust private insurance market with Dual Purpose Insurance benefits based on need. These two pieces work best together, but can work separately as well. These ideas can generate substantial savings to the system, both public and private, which can be repurposed for what to date has been wishful thinking – to cover those with disabilities, as well as provide stipends to caregivers and/or provide respite care.

The full paper can be accessed at www.LTSS-Financing-Insights.org