PERSONAL FINANCE

Opinion | The pros and cons of long-term-care insurance. Could it be right for you?

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Long-term-care insurance has serious drawbacks and warrants a skeptical eye if you're considering it, David Aston writes.

Dreamstime

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Many Canadians worry about the financial threat of high care costs late in life. Some advisers advocate long-term-care insurance as a possible solution.

While the idea of insuring against a worrisome risk like care costs has intuitive appeal, long-term-care insurance has serious drawbacks and warrants a skeptical eye if you're considering it.

In my opinion, it's expensive for what you get. Also, long-term-care insurance narrowly targets one potential threat when you're usually better served by flexible finances that can address several challenges. Moreover, it won't cover some forms of high care costs.

An alternative approach to covering late-life care needs

This is the third in a series of columns on financial challenges from encountering residential care needs late in life. The first column described the main care options — in-home care, retirement homes and long-term-care homes — and what they cost. The second column discussed the potential to fund care needs with backup assets such as a paid-for home.

While long-term-care insurance offers an alternative approach, it usually doesn't work as well as the more common practice of using general income, savings and assets to fund care costs. However, individual circumstances vary and long-term-care insurance can make sense in specific situations.

Long-term-care insurance is a widely used product in the U.S. (where conditions are different). But there are now only two providers offering it on a stand-alone basis in Canada, says Lorne Marr, director of business development at HUB Financial, a managing general agency for insurance brokers. (Marr says several other insurers offer it as conversions on other types of insurance like critical illness insurance or disability insurance.)

I find the approach offered by Sun Life Retirement Health Assist to be the more promising of the two options, since it provides regular cash payouts that you can use however you want for as long as you need care.

The other provider, MyDignity Home Care Assistance Plan, reimburses specific care expenditures and is capped by total spending and individual spending category. Since the biggest concern is trying to cover the possibility of runaway care costs, I don't see much point in a policy that caps payouts in this manner.

In both cases, you purchase long-term-care insurance and start paying premiums when you're relatively healthy, to help cover care costs should you become sufficiently dependent on care later in life.

Benefit payouts are triggered if you meet a particular threshold of care dependency involving: severe cognitive impairment or two of six activities of daily living: bathing, dressing, feeding, toileting, continence and transferring (e.g. into or out of bed).

Understand long-term-care insurance shortcomings

Unfortunately, long-term-care insurance doesn't match the classic ideal of the insurable event in its optimal form. Insurance is generally most cost-effective when you're insuring against a small probability of catastrophic loss. That way the insurance company is able to charge modest premiums and still protect you against a loss that is too large to absorb easily on your own.

However, needing long-term care isn't exactly a low-probability event. Some estimates place your odds of requiring some amount of nursing-home-level care at almost 50 per cent. That necessarily means that long-term-care insurance premiums are relatively expensive compared to the potential payouts they generate after also accounting for sales, administration and insurer financing costs.

If you end up requiring a lot of care and move to a government-subsidized long-term-care home, that doesn't necessarily qualify as financially catastrophic because the government ensures no one is turned away due to affordability. While government long-term-care homes (also known as nursing homes) have their shortcomings, to an extent at least, the government has your back. (In the U.S., government support for long-term-care homes is far more limited. That contributes to long-term-care insurance being far more common in the U.S.)

If you need only a small to moderate amount of care and are still fairly active, you may want to get in-home care or move to a retirement home. The province provides very limited support for in-home care and essentially no support for retirement homes, so you largely need to pay for these types of residential care out of your own pocket. And those costs can be hefty.

Unfortunately, your long-term-care insurance policy won't help you if you need some care but aren't dependent enough to meet the criteria for long-term-care insurance benefit payouts, which sets a relatively high bar. If you need a caregiver to help with bathing, but you're of sound mind and don't need help with any of the other six defined activities of daily living, then you won't get benefits. "There are a lot of people in retirement homes that wouldn't qualify for a claim," says Marr.

Furthermore, long-term-care insurance pays out only if you're dependent on care, but what happens if you live into your nineties, stay relatively healthy, but run short of money for other reasons? In that situation, you might regret all the long-term-care insurance premiums you paid — and must continue to pay to ensure your policy doesn't lapse.

Long-term-care insurance is a narrowly targeted product that addresses one financial risk, but the cost of the premiums detracts from your ability to save for and counter other possible threats.

Generally, it's a good idea to stay flexible with your financial resources. In my last column, I discussed the strategy of making use of flexible backup assets such as a paid-for home, although it could also include other assets or extra savings.

You can potentially tap into backup assets to cover a variety of unplanned extra financial needs late in life. If everything works out well and you live a long life, stay healthy, and your finances prosper, then you can leave backup assets as a bequest to your heirs or charity.

Long-term-care insurance can make sense in special situations

While long-term-care insurance warrants skepticism, you should assess it according to your individual preferences and situation. A special circumstance where I think long-term-care insurance might make some sense is if you put a high priority on having funds available late in life for an expensive private facility providing nursing home-level care.

This may apply if you're adamantly opposed to relying on public long-term care homes for care and are willing to put other financial needs that may arise at far lower priority. It also helps if you don't have a paid-for home or other backup assets to tap but still generate enough steady income (e.g. from an employer pension) to comfortably afford long-term-care insurance premiums for an indefinite period.

Example of long-term-care insurance premiums and benefits

To provide a taste of how long-term-care insurance works, here's an example: a Sun Life long-term-care insurance policy purchased at age 60 with a potential benefit of $8,000 a month. Monthly premiums are $444 for males, and $689 for females, according to a quote obtained last week by Marr. To maintain coverage, you keep paying premiums until a claim for benefits is approved.

While I don't have space to describe all pertinent details of this complex product, two deserve highlighting. Firstly, Sun Life reserves the right to increase premiums after the first five years, so you can't count on your costs staying the same.

Secondly, benefits aren't adjusted for inflation prior to the point where they start to be paid. This diminishes their "real" value in today's dollars, particularly if payouts start far in the future. If benefit payouts for this example policy were to start in your late eighties, the real value of the $8,000 monthly benefit would be cut roughly in half (assuming annual inflation of 2.5 per cent). However, as Marr points out, the real cost of the premiums in today's dollars also gradually declines due to inflation.

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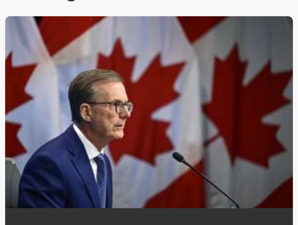

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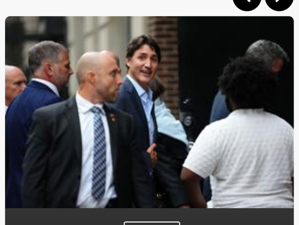

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