

TRUE GROUP LONG-TERM CARE COVERAGE: A BETTER DESIGN FOR THE FINAL PIECE IN THE EMPLOYEE BENEFIT SAFETY NET

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Despite the robust growth in this segment of the long-term care insurance market, group long-term care insurance fails to provide many of the features and advantages of a true group benefit. Employees gain a modest discount over individual insurance products and the convenience of payroll deduction but little else. Even though under today's tax laws employer contributions are pretax, few employer contributions are made. Compared to other group benefits and insurance products, group long-term care insurance provides employees with little advantage over purchasing insurance for themselves in the individual market. What if insurers approached the design of long-term care insurance products more like the design of other group products? What might such products look like, and what would be their advantages over currently available group products?

Current Group Products: What is Missing?

Current employer products provide a few nice features for employers and employees. First, they provide ease of enrollment. Second, obtaining long-term care coverage through an employer can be less expensive than purchasing an individual policy due to some savings in commissions.

However, if offering meaningful benefits that perform an important safety net function is the purpose of providing employee benefits, current employer long-term care products fail to deliver in one important way: too few employees end up with the coverage. Because of that, growth in the employer market is limited. Participation in employer sponsored plans is often no more than 6% to 15% of eligible employees, and it can be as low as 1% to 2%.

At one level, long-term care appears to be less relevant than other benefits. An employer appears to have less immediate concerns about the risk. However, the lack of a long-term care benefit can undermine the value of retirement benefits. In current dollars, a five-year nursing home stay would cost over \$300,000, which could easily consume the benefits a couple has accumulated in their 401(k) or other retirement accounts, making their retirement benefit insufficient. Thus long-term care coverage becomes an add-on to protect the retirement income.

Employers today face a dilemma if they offer long-term care insurance. They can choose to offer it as a voluntary, employee-paid benefit. The high cost to the employees, however, results in low participation. Or they can offer it with an employer contribution toward the cost to achieve higher enrollment, resulting in high cost for the employer. The problem is that current products and enrollment methods cover all employees and do not distinguish short-term from long-term employees.

One type of product that attempts to provide a compromise between these two positions is the core buy-up coverage. Under these programs, an employer purchases a low-cost "core" benefit for every employee. The employee then has the opportunity to "buy-up" to a higher benefit level. However, the core program usually does not provide adequate coverage for a retiree, either by not providing inflation protection or by providing a low benefit amount. For those who do not buy up, there are two possible disadvantages:

Employees think they are covered adequately for long-term care expenses, when they are not
Employees who do not appreciate a long-term care benefit receive it anyway and will likely lapse it before they reach the age when they would use it.

It seems that the employer is wasting money on those who do not buy up.

True Group Long-Term Care

Long-term care insurance designs today are not consistent with how employers offer other lifelong benefits – only to longer-term employees, and including some employer contribution to cost. In order for group long-term care coverage to take off, it will need to become a true group benefit that encourages high employer and employee participation. A summary of the differences between true group (as we define it) long-term care coverage and current employer long-term care coverage is presented in the following table.

Contrast of True Group and Convenience Long-Term Care Plans	
True Group Long-Term Care	Current Employer Long-Term Care
Employer Contribution	No Employer Contribution
Targeted at long-term employees using waiting periods and/or vesting	Participation available to all employees immediately
Plan offered to dependents, if it meets employers’ objectives	Plan offered to spouses, parents, retirees, others to maximize insurance company prospecting
Benefit design set by employer and may be changed	Benefit design set by insurer and immutable
Possibly self-funded or alternate financing	Always fully insured
Commissions always removed	Commissions may be removed
High participation expected, providing meaningful safety net	Participation at most 6% to 15%
Cost to employer around \$5 to \$25 per employee per month	Negligible cost to employer

How to Incorporate True Group Features

In a true group long-term care plan, the employer takes on some responsibility for the long-term care benefits of its employees. In return, the employer can share cost with employees and limit its exposure only to those employees who are employed for a longer term. True group features, such as employer contributions, waiting periods, and vesting, enable employers to offer a plan with lower costs that is directed at long-term employees who are truly interested in the benefit.

Vesting rules indicate whether departed participants are eligible for benefits funded by employer contributions. Vesting rules reward and retain valuable employees while keeping the per employee cost lower. Waiting periods and vesting requirements can have a significant impact on cost. For defined benefit pension plans, most employers require five years of service before employees are eligible for any pension benefits, and then they are eligible for full pension benefits. This is known as “cliff vesting”. Graduated vesting would create complexity that is: a) difficult to describe to employees, and b) difficult to administer. Therefore, cliff vesting is advisable for a group long-term care plan.

During waiting periods, employees cannot contribute and would not be eligible for benefits. Waiting periods reduce administrative costs for short-term employees and reduce costs overall because fewer employees participate. On the other hand, an overly long waiting period can undermine the objective of attracting employees.

There are two critical questions when designing employee contributions. The first is the percentage of the cost that the employee (or spouse) pays. Second is the time period over which the employee makes payments. Note that the contribution periods might differ for the employer and the employee. Most long-term care policies are paid for over the lifetime of the insured. In designing a true group plan, the employer would almost certainly want to pay contributions only for the expected working life of the employee, to age 65 for example. They may choose to have the employee pay premiums for life. This enables the employer-paid benefits to be fully accrued during the employee’s working life, while keeping premiums payments for the employee as low as possible.

Why Bother?

The current group long-term care insurance market is growing, so why would an insurer stick its neck out to design such different products?

The long-term care financial crisis has been creeping up on Americans for years. However, in 1996, the passage of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) defined how long-term care coverage can be offered as a tax-preferred employee benefit. More employers, including the federal government and many state governments, are making long-term care insurance available through payroll deduction. But these “convenience” benefits are not consistent with the safety net provision goals of the employer due to the low participation rates among eligible employees. This low participation undermines the reasons for providing benefits in the first place, and offers little in the way of a safety net for the employee population.

In order to provide a meaningful safety net benefit in this important and often neglected area, employers need to find a method for offering this coverage such that employee participation is encouraged while keeping employer costs reasonably low. It seems to be only a matter of time before alternative approaches to offering and funding long-term care coverage will be sought.

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