

IN BRIEF

**Inflation Protection and Long-Term Care Insurance:
Finding the Gold Standard of Adequacy**Introduction and Purpose

This *In Brief* summarizes the findings of the AARP Public Policy Institute issue paper, *Inflation Protection and Long-Term Care Insurance: Finding the Gold Standard of Adequacy*.¹ The long-term care (LTC) insurance market has grown rapidly over the past decade. Given that many individuals who purchase LTC insurance policies may not access benefits for many years, it is important that insurance benefits keep pace with inflation. To address this issue, AARP commissioned a study to determine whether a policy that includes a 5 percent compound inflation option is adequate to meet the future costs of long-term care.

Key Findings

- About 40 percent of all new buyers of long-term care insurance policies purchase inflation protection.
- The probability of having a policy with inflation protection decreases with age: 59 percent of individuals under age 65 purchase inflation protection, whereas only 14 percent of individuals over age 75 do so.
- The average age at which policyholders access long-term care services is 82.
- The adequacy of the inflation protection depends in part on the types of services used. This analysis examined historical trends in service costs, age at time of purchase, gender, and state of residence. Using 1999 data on long-term care insurance policyholders, it was expected that the typical policyholder would begin to use services between 2015 and 2020. The analysis found that:
 - On average, in a medium inflation scenario², a policy with 5 percent inflation protection would cover 74 percent of the *daily* cost of nursing home care (at the time that services are first used), 91 percent of daily assisted living costs, and 95 percent of the costs of a home care visit.
 - In terms of the *total* long-term care liability over the duration of use, a policy with 5 percent inflation protection would cover 70 percent of nursing home costs, 82 percent of assisted living costs, and 90 percent of home care costs.
 - Self-insuring for the inflation risk (for example, by investing money for future long-term care needs rather than purchasing insurance) or purchasing a more modest

¹ PPI Issue Paper # 2002-09 July, 2002.

² Medium inflation was defined as 5.78 percent for nursing homes and 4.37 percent for home care services.

compounding level (e.g., 3 percent annually) makes sense only for older purchasers (age 70 and over).

Conclusions

Given the historical trends in long-term care costs, the insurance policy designs that individuals purchase, and the projected trends in use of institutional and home and community-based care services, a 5 percent compound inflation rider is likely adequate to finance the future long-term care costs of most policyholders: more than 80 percent of the costs of care will be covered by such policies. However, this conclusion depends on the continued shift in service use away from nursing home care and toward assisted living and home and community-based alternatives. Even with inflation protection, those entering nursing homes may bear considerable cost. Those using home and community-based care risk overinsurance. Clearly, the purchase of inflation protection makes the most sense for young buyers. Even in periods characterized by modest rates of inflation, 5 percent compound inflation protection is warranted.