REPORT OF THE
SECRETARY OF HEALTH AND HUMAN RESOURCES AND
THE BUREAU OF INSURANCE

# STUDY TO DETERMINE THE BENEFITS AND COSTS OF TAX INCENTIVES AND OTHER MECHANISMS TO ENCOURAGE THE PURCHASE OF LONG-TERM CARE INSURANCE

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA


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# COMMONWEALTH of VIRGINIA

*Office of the Governor*

George Allen
Governor

Kay Coles James
Secretary of Health and Human Resources

February 20, 1995

TO: The Honorable George Allen

and

The General Assembly of Virginia

The report contained herein is pursuant to Senate Joint Resolution 103, agreed to by the 1994 General Assembly.

This report constitutes the response of the Secretary of Health and Human Resources and the Bureau of Insurance to study methods to encourage the purchase of long-term care insurance.

Respectfully Submitted,

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# Senate Joint Resolution 103

## Study to Determine the Benefits and Costs of Tax Incentives and Other Mechanisms to Encourage the Purchase of Long-Term Care Insurance

## INTRODUCTION

Disability is a risk facing everyone reaching his or her later years. Approaches for financing long-term care, however, remain imperfect. As the aging population expands due to both growth and increased longevity, the necessity of viable funding mechanisms becomes clear.

Most care is still provided by family or friends on an informal basis. Institutional care in nursing homes is financed primarily by public funds through the Medicaid program (about 60%) or out-of-pocket (about 35%). Private care insurance pays only about 3% of nursing home care in Virginia. Although home and community-based care provided for payment is expanding rapidly, most at-home care is still provided by family or friends. Similar to the case for nursing homes, private insurance plays a limited role in the payment for home-based services.

The current funding structure for long-term care for the disabled often creates a hardship for the consumer. To qualify for Medicaid requires a person to already be in or to "spend-down" to poverty. Alternatively, an individual will need substantial private assets to finance an extended period of long-term care.

The dilemma created is both social, in terms of ensuring that our elderly receive adequate care, and economic, in terms of balancing public expenditures and appropriate care. At present the Medicaid program, originally designed as a program for the indigent, is expending ever increasing dollars on long-term care for the elderly. Nationally, Medicaid pays for about half of all nursing home care and in Virginia Medicaid pays for almost two thirds. Unless other means are developed to finance care, including making it the responsibility of the individual except in cases of true indigency, long-term care may become almost solely the responsibility of the government.

One solution is to expand the role of long-term care insurance. As reported in 1994 Senate Document 17 regarding public-private long-term care insurance partnerships, the single overriding problem with long-term care insurance is lack of interest by the public. Initially, certain factors limited interest in long-term care insurance. Products introduced in the 1980's had flaws including inadequate coverage and insufficient consumer safeguards. Products also were available only on a limited basis. However, efforts to improve policy design have been reasonably successful, at least enough so to remove product limitations as a major barrier. Similarly, product availability no longer poses a significant problem.

Even so, the public shows little interest in long-term care insurance. Affordability is still an issue. Most persons purchasing long-term care insurance wait until their sixties, when policies are considerably more expensive. Since few younger purchasers participate, the broad pool of insured persons necessary to reduce the cost generally is not in place.

1994 Senate Document 17 proposed several options, including providing group long-term care insurance policy options to employees of the Commonwealth and encouraging other employers to provide long-term care insurance, and expanding consumer education about long-term care financing options. However, these initiatives, even if pursued, still will bring a fairly small number of Virginians into the long-term care insurance market.

This study, therefore, proposes a public-private model that will use tax incentives to encourage purchase of long-term care insurance. It is intended that, in combination with better consumer understanding of potential long-term care needs and financing and improved insurance products, the trust fund model described will provide an additional incentive to individuals to take financial responsibility for their future long-term care requirements.

## OPTIONS BEING CONSIDERED IN OTHER STATES

States groping for solutions to long-term care financing have considered a number of options. The public-private partnerships advocated by the Robert Wood Johnson Foundation were discussed in the 1994 study.

An alternative financing model developed in Hawaii would create a "contribution" based state trust fund that would cover long-term care services for residents of the state. This proposal, developed by a Long Term Care Financing Advisory Board in response to a legislative mandate, would base the contribution on annual income and would be available to all residents of Hawaii.

Eligibility would be unrestricted in terms of age, medical condition or other underwriting procedures, and participation would be mandatory. Program participants would be permanently vested for full benefits after 40 annual credited contributions.

Covered services would include care that is necessary for two of six Activities of Daily Living and designed to alleviate the individual's impairments. Care provided in both facilities and the community and home, including services in nursing facilities, community based care, home health care and home care, would be be included. The program would not cover hospital and other acute care, services covered by other insurers and services eligible for Medicaid reimbursement.

Hawaii's model varies from the model proposed below in several ways. First, the Hawaii model is basically a social insurance model, i.e., it uses tax generated funds to ensure that all persons in the state are covered either by Medicaid or the trust fund. By contrast, the model presented in this report would use tax incentives to encourage the purchase of private long-term care insurance. Secondly, the Hawaii trust fund would presumably be a direct payor for services or work through a benefit manager. In the following model, the trust fund would pay for insurance and depend upon the private insurance market.

## OTHER TAX INCENTIVE OPTIONS

In the 1994 Senate Document 17, advantages and disadvantages of tax incentives were addressed. Review of information published since the previous report and programs in others states have not identified any new programs or approaches of note. As noted in last year's study, tax incentives can target either purchasers (employers on behalf of employees or individuals) or insurers. As there are apparently sufficient products available in Virginia at this time, this study focuses on buyer participation.

Tax incentives can include income tax deductions or credits for long-term care premiums. Incentives can also address deductions or credits for long-term care expenses including co-payments, deductibles and premiums. An important issue concerns the target population. The success of tax incentives may be limited due to lower tax liability of many long-term care insurance policy purchasers as well as beneficiaries. Tax incentives are probably most useful in targeting younger, working purchasers. This also allows tax credits to create an incentive for employers to participate by providing long-term care insurance as a benefit.

Individual medical accounts (IMAs) were also discussed in last year's study. Renewed interest in this approach may be appropriate. Tax incentives may induce individuals to save through the IMAs and use the savings accounts to pay for care or to pay for long-term care premiums.

As noted in last year's report, the federal government explored tax incentives when it studied long-term care insurance in the 1980s. At that time, it did not pursue federal tax incentives because of concern that reductions in the use of public resources might not offset the tax revenue lost. Legislation currently before Congress includes some tax incentives to encourage the use of long-term care insurance. However, long-term care also is not of highest priority in the Congressional discussions at this time. The availaibility of federal tax incentives for long-term care insurance in any legislation Congress enacts is uncertain.

## PROPOSED TRUST FUND MODEL

### OPTION 1
### Long-Term Care Trust Fund

- A Long-Term Care Trust Fund (LTC Trust Fund) would be developed by the Department of Medical Assistance Services, with assistance from the Department of Taxation and the State Corporation Commission's Bureau of Insurance. The trust fund would provide a saving and investment mechanism, with (state) tax benefits available to individuals and employers contributing on behalf of individual employees.

- The LTC Trust Fund would offer for sale to Virginia residents LTC insurance bonds in specified denominations (to be determined). These bonds would be invested in

revenue generating trust fund accounts. After reaching a minimum age (to be determined) individuals possessing LTC insurance bonds could redeem their account balance in the form of vouchers for long-term care insurance premiums.

- Incentives in the form of tax credits would be offered to individuals and to employers who partially or fully contribute to the LTC Trust Fund on behalf of their employees. Both individuals and employers would be allowed to purchase bonds; however, all accounts would be set up as individual accounts.

- Voucher amounts will be determined based upon factors including the individual's age and health risks.

The following points serve as the basis for the proposed trust fund model:

- A major disincentive to purchasing long-term care insurance is the premium price. Long-term care insurance is purchased most frequently by individuals in their sixties or above. Premiums are fairly expensive at this age; in addition, many or most purchasers are retired and have limited disposable income. Therefore, a subsidy or savings mechanism specifically directed to this purpose would enhance interest in long-term care insurance by making it more affordable.

- Using a trust fund administered by the state and funded through private funds provides a public-private structure to enable individuals to use a safe, regulated savings mechanism to accumulate resources for potential long-term care needs.

- Tax credits will provide an incentive, in addition to providing for possible future needs, that will encourage both individuals and employers to participate in the LTC Trust Fund.

OPTION 2

Long-Term Care Trust Fund and Medicaid Reinsurance Model

If the Long-Term Care Trust Fund does not generate sufficient public interest to generate an impact on long-term care costs, an adjunct alternative is to develop the trust fund in conjunction with a public-private partnership similar to that developed in New York state with grant funding from the Robert Wood Johnson Foundation. That model

was described in 1994 Senate Document 17 (page 8). Under the program, an individual purchases a state-approved private long-term care insurance policy. The policy must cover three years of nursing home care, six years of home care, or a combination of the two (a day of nursing home care is deemed equivalent to two days of home care). Once private benefits have been exhausted, the participant automatically qualifies for the state's Medicaid program. New York's program allows all assets, regardless of amount, to be kept by an individual who becomes eligible for Medicaid once private insurance benefits are spent.

The rationale for using this approach in combination with the trust fund is to make insurance more affordable. This model assumes that the use of Medicaid as reinsurance will lower the premium prices for long-term care insurance, making the policies more attractive. It should be noted that, as reported in the 1994 study, federal legislation enacted in 1993 requires states to recover Medicaid expenditures from estates, including assets that would be protected under a New York type program. This type of program will not be feasible unless Congress reverses its 1993 action.

## RECOMMENDATIONS

1. The Department of Medical Assistance Services, with the cooperation of the Department of Taxation and the State Corporation Commission's Bureau of Insurance, should develop a Long-Term Care Trust Fund. The LTC Trust Fund will offer for sale to Virginia residents long-term care insurance bonds that will be redeemable after a specified age and must be applied to the purchase of long-term care insurance. Tax incentives will be available to individuals and to employers purchasing bonds on behalf of their employees.

2. If the LTC Trust Fund does not generate sufficient public interest, it will be combined with a Medicaid reinsurance program modeled after New York state's public-private long-term care insurance program, with the intent that Medicaid reinsurance will sufficiently reduce premium prices to make long-term care insurance more affordable and attractive.

## CONCLUSION

The model proposed should serve several purposes. First, it offers a concrete starting point for developing a mechanism to move Virginia forward in the purchase of long-term care insurance. This report presents this model as a starting point. Significant additional work will be required to move this from concept to reality, including actuarial and economic analyses to determine necessary parameters and appropriate design, tax implications, and feasibility.

In addition, by relying on the private long-term care insurance market, the model necessarily will incorporate any existing or future problems in that market place. Restrictive underwriting requirements make obtaining long-term care insurance difficult or impossible for some individuals with existing conditions. Research into this area and others will be necessary to point out other system-wide issues and identify solutions.

Given these caveats, this model is presented as a viable beginning to protecting the aging in Virginia from catastrophic costs and inadequate long-term care. Efforts in this arena will need to be collaborative and ensure coordination and cooperation among state agencies and between the public and private sectors.