



Primer:

Linking Reverse Mortgages and Long-Term Care Insurance

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This is the first in a series of papers in the Retirement Security Project supported by a grant from The Pew Charitable Trusts.¹ Future subjects will include strengthening incentives for moderate income households to save for retirement; understanding the interconnectedness of retirement savings and long-term care; and identifying policies to promote informed consumer decisions around long-term care insurance.

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Linking Reverse Mortgages and Long-Term Care Insurance

As the retirement of the baby boom generation approaches, policy makers are considering ways to better prepare seniors for their retirement and long-term care needs. One idea that has received recent attention is linking reverse mortgages to the purchase of private long-term care insurance. Regulations to implement legislation passed in 2000 encouraging this linkage are expected to be released in the spring of 2004. This issue brief explains the fundamentals of reverse mortgages and long-term care insurance and outlines the opportunities and challenges with the linkage.

Overview

Large and Often Unanticipated Cost of Long-Term Care. One of the major, unaddressed threats to retirement security is the cost of long-term care (LTC). It is estimated that at least 40 percent of the elderly will have a nursing home stay, and that 10 million people have become disabled enough to need nursing care in the home or at a nursing facility.²⁻³ Long-term care in nursing homes costs around \$150 a day on average.⁴ For people staying a year in a nursing home (the average stay is 2.6 years), the annual cost of care is greater than \$50,000, and those costs are expected to increase over time at a rate greater than inflation.⁵⁻⁶ Nursing services provided in the home can be equally costly. Unlike other health services, individuals – not public or private insurance – are primarily responsible for paying for these costs.

² The Health Insurance Association of America (HIAA), “Guide to Long-Term Care Insurance,” 2003.

³ S. Rogers and H. Komisar, “Who Needs Long-Term Care?” Found at www.ltc.georgetown.edu.

⁴ Mature Market Institute, “Metlife Market Survey on Nursing Home and Home Care Costs,” 2002. Found at www.aarp.org.

⁵ American Council of Life Insurers, “Can Aging Baby Boomers Avoid the Nursing Home?” March 2000. Found at www.metlife.com.

⁶ U.S. Department of Labor, Bureau of Labor Statistics, 2001. Found in the National Association of Insurance Commissioners (NAIC), “A Shopper’s Guide to Long-Term Care Insurance,” 2003.

Fragmented System. Despite the estimated cost of paying for LTC services and the strain it puts on retirement savings, very few people in or approaching retirement have private resources or sufficient public benefits to protect them from long-term care costs. Most people who need long-term care pay for it on their own, or rely on family members to act as informal caregivers. Approximately 25 percent of formal LTC is funded out-of-pocket, and nearly one in four families in this country provides informal care in the home.⁷⁻⁸ For those who exhaust their savings and continue to need medical care, and for those with limited incomes and assets, Medicaid may pay for their care. Medicaid, by default, has become a major financier of LTC, paying for nearly half of all nursing home care.⁹ It also pays for a limited home- and community-based care benefit. Thirty-five percent, or roughly \$75 billion, of Medicaid benefits expenditures in 2002 were attributable to LTC.¹⁰ Since states pay for roughly 43 percent of Medicaid costs (\$110 billion in 2002) (with the rest funded by the federal government), long-term care now represents a significant, growing and probably unsustainable portion of their budgets.¹¹ Medicare, the other major public insurer, has very limited LTC benefits.¹² With the recent addition of a drug benefit, Medicare is unlikely to expand its LTC coverage in the near future.

A Limited Private Insurance Market. Private LTC insurance is a small but growing source of coverage for nursing home and home-based care costs. LTC insurance shields policyholders from much of the catastrophic costs of LTC, provides them with more care options than Medicaid would, and possibly reduces reliance on Medicaid.¹³ However, as of 2001, there were only 5.8 million policies in force.¹⁴ Lack of awareness of the risk of needing LTC, and concerns about the quality and cost of the products are typically named as the reasons for the low take-up of LTC insurance. To promote the purchase of LTC insurance, Congress has enacted several initiatives such as a limited tax deduction for premiums similar to the deduction for medical insurance premiums purchased by individuals; the Federal Long Term Care Insurance Program for federal employees; and a consumer education campaign on LTC and Medicare through the Centers for

⁷ CMS, National Health Accounts, www.cms.hhs.gov. National Health Expenditures data from 1997-2002 indicate that about 25% of spending on nursing home and home health services is paid for out-of-pocket.

⁸ The survey found that 23% of households had provided care to a family member within the past 12 months. From the 1997 National Family Caregiver Survey results found in AARP, "Caregiving and Long-Term Care," at www.aarp.org.

⁹ CMS National Health Expenditures, January 2002, found in NAIC's "A Shopper's Guide to Long-Term Care Insurance," 2003.

¹⁰ CBO March 2003 Public Baseline. LTC accounts for 35% of spending by Medicaid on health benefits. Calculation of total state and federal spending on LTC by authors.

¹¹ Ibid.

¹² Medicare covers home health services in limited circumstances (when physician certification and homebound requirements are met) and skilled nursing facility services after a qualifying hospital stay, but only for 100 days.

¹³ Medicaid generally restricts LTC payment to services provided in nursing homes. There are some waivers to provide care in home- and community-based settings.

¹⁴ HIAA, "Long-Term Care Insurance in 2000-2001," Jan. 2003. The report indicates that 8.26 million policies have been sold and that 7 of 10 policies remain in force (70% of 8.26 million = 5.8 million). Policies lapse do to death, voluntary lapse, or replacement with a new policy.

Medicare and Medicaid Services (CMS). The impact of these activities may increase over time, but the number of people purchasing LTC insurance remains small.

New Policy: LTC Insurance-Reverse Mortgage Link. A new policy is on the horizon to promote the purchase of private LTC insurance. Regulations will likely be issued in 2004 by the Department of Housing and Urban Development (HUD) to implement a 2000 law (The American Homeownership and Economic Opportunity Act of 2000) providing an incentive to finance LTC insurance through reverse mortgages. A reverse mortgage provides access to the equity in the home while allowing the homeowner to remain in place and not have to repay the loan until the home is sold. Currently, the proceeds from a reverse mortgage can be used to pay for LTC insurance, or for any other purpose. However, with the new law, a government-backed reverse mortgage program (the Home Equity Conversion Mortgage (HECM) program) will provide a financial incentive to homeowners who use their entire loan payout to purchase a qualified LTC insurance policy. The rationale behind the LTC insurance-reverse mortgage link is that it allows seniors to tap into the value in their homes while protecting their retirement income and other assets from the potentially catastrophic costs of long-term care. To the extent that people purchase LTC insurance, thus reducing the number of people who “spend down” to Medicaid, this proposal could help relieve the strain on state and federal budgets. However, this policy also raises questions such as whether limiting the use of reverse mortgage to LTC insurance is too restrictive, whether there are adequate consumer information and protections for both of these products, and how the policy will be implemented.

This issue brief describes reverse mortgages and LTC insurance, the new policy, and issues and opportunities associated with the linkage. It is intended to serve as a resource for those tracking LTC and retirement security policy generally as well as for those reviewing the plan for implementing the LTC insurance/reverse mortgage link, which should emerge in the coming months. This report is one of a series of activities conducted by the Retirement Security Project to bolster the financial security of America’s aging population by raising retirement savings and improving long-term care insurance products.

Reverse Mortgages

Reverse mortgages allow older Americans access to the equity they have accrued in their homes without requiring them to leave or sell their homes.¹⁵ Borrowers can use this equity to make home repairs, pay taxes, supplement their income, pay for long-term care costs, or for anything else they desire. Reverse mortgages

¹⁵ Home equity loans also allow access to equity, but they must be paid back immediately. To pay back this type of loan requires a monthly income large enough to cover living expenses and loan payments, and therefore, home equity loans may not be appropriate for retired people on fixed-incomes.

are generally available to people who own their homes outright, or who have very limited mortgage debt.¹⁶ The loan is made from the lender to the homeowner against the sale value of the home. Loans are repayable when the sole remaining borrower dies, or when the home is no longer the primary residence of the borrower(s) through the sale of the home or a permanent move to a new residence, such as an assisted living facility or nursing home.

Types of Reverse Mortgages. There are, generally, two types of payments available from a reverse mortgage, depending on whether the homeowner wants a steady stream of income (monthly) or more flexibility (line of credit). “Term” and “tenure” mortgages pay out a fixed monthly dollar amount. Term reverse mortgages pay out the loan amount over a fixed period of time. Tenure plans make payments to homeowners for as long as they stay in their home; as such, the monthly payments tend to be smaller than under a term mortgage. Borrowers can also receive the loan as a lump-sum cash payment or an open equity line of credit, both of which allow for larger sums of money to be available at the beginning of the loan. Reverse mortgages also may be set up so that homeowners receive both monthly payments and access to an equity line of credit when needed.¹⁷

Amount from Reverse Mortgages. The amount of home equity that is accessible through reverse mortgages depends on several factors. First, the payment type selected by the borrower of reverse mortgage matters. People who choose tenure loans (i.e. for as long as they remain in their home) generally receive less per month than people who choose shorter, fixed-term mortgages. Second, people with homes with higher values have access to larger loans than those with lower-valued homes.¹⁸ Third, the amount of equity available depends on the interest rate. The loan amount (plus all of the accruable interest and other fees) is calculated not to exceed the expected value of the home at the time of sale.¹⁹ Fourth, age affects both the loan limit and the monthly income available from a reverse mortgage. Lenders assume that the older a person is the shorter the payout time will be before death or sale of the home. Therefore, older borrowers can get more money for the same home value. The table below illustrates this point. Lastly, homeowners can borrow as little or as much (up to a limit) of the equity they need.

¹⁶ People who still owe money on their home mortgage at the closing of a reverse mortgage must pay off the first loan with a lump sum from the reverse mortgage payout. From www.rmaarp.com.

¹⁷ HUD, “Evaluation Report of FHA’s Home Equity Conversion Mortgage Insurance Demonstration,” 2000.

¹⁸ In the HECM program, the amount that can be borrowed is also limited by the median value of homes in the county. Approximately 30% of the HECM borrowers analyzed in the 2003 HUD evaluation report, “Refinancing Premium, National Loan Limit, and Long-Term Care Premium Waiver for FHA’s HECM Program,” had home values higher than the median for the county.

¹⁹ *ibid.*

HUD HECM	With a Home Value of \$100,000 ²⁰	Loan Amount ²¹
Age 62	Cash or Line of Credit	\$48,395
	Monthly Income	\$278
Age 72	Cash or Line of Credit	\$57,877
	Monthly Income	\$368
Age 82	Cash or Line of Credit	\$68,563
	Monthly Income	\$544

Reverse Mortgage Guarantees. Reverse mortgages are designed to limit both the homeowner’s and the lender’s exposure to financial loss. The loan amounts are limited so that the borrower’s debt is expected to be less than the value of the home at the time of sale. If the loan balance is greater than the value of the home at the time of sale the borrower is not responsible for paying the difference. In theory, the lender would lose money in that scenario. However, nearly all reverse mortgages are insured against this loss, mostly through the Home Equity Conversion Mortgage (HECM) program, administered by HUD. HECM borrowers pay an upfront and monthly insurance premium (deducted from the loan amount) toward an insurance pool that is used in cases where the mortgage debt exceeds the value of the home at the time of sale or when a lender fails to make monthly payments to the borrower.²²

The Reverse Mortgage Market. Many local banks and other lenders offer reverse mortgages that are insured through HUD’s HECM program. Fannie Mae both purchases HECM loans from lenders (as it does in the forward mortgage market) and has its own reverse mortgage product called the Homekeeper. Reverse mortgages are a small percent of the business lenders do each year in the home loan market, and few participants in the reverse mortgage market process more than a couple of these loans a month.²³ Reverse mortgages result in less profit than forward mortgages for loan originators and the loan process is much more cumbersome.²⁴ These issues contribute to a small market for reverse mortgages.

²⁰ HECM loan amounts are limited by the median home value for the county in which the borrower resides. In the example above, the \$100,000 value home provided similar payout amounts in several counties we checked throughout the United States, but a more valuable home may be affected by the limits for its area.

²¹ These loan amounts were calculated by the Financial Freedom loan calculator. Financial Freedom is a private company that offers its own reverse mortgage product in every state (and offers jumbo reverse mortgages as well.) The loan amounts are based on interest rates from December 1, 2003. The loan calculator can be found at www.ffsenior.com/calculator.

²² It is the upfront premium that is waived on a HECM loan when the borrower purchases a qualified LTC insurance policy.

²³ HUD, “Evaluation Report of FHA’s Home Equity Conversion Mortgage Insurance Demonstration,” 2000.

²⁴ Ibid.

Few Have Reverse Mortgages. Demand for these types of loans has been limited. Since the HECM program began as a demonstration in 1987, HUD has endorsed about 100,000 loans and even fewer have been originated by the Fannie Mae program or by private entities.²⁵ In its 2000 report, *Evaluation Report of FHA's Home Equity Conversion Mortgage Insurance Demonstration*, HUD found that there is a perception among homeowners that these loans are expensive, mostly because the closing costs can be a high percentage of the total loan (sometimes as high as ten percent). With interest, closing costs, loan servicing fees, and the HECM insurance premium, potential borrowers may find that a reverse mortgage is too expensive as a means of financing their needs or that the equity available in the end is insufficient. Further, people may be reluctant to incur debt and reduce the value of what they have worked their lifetimes to pass down to their heirs.

Who Gets Reverse Mortgages. The 2000 HUD study of the HECM reverse mortgage programs shows that its participants tend to be older, racially and ethnically mixed, and people who live alone. HECM borrowers are slightly older on average than all homeowners eligible for the HECM program, and people living alone are disproportionate users of HECMs.²⁶ For example, women living alone represent around 30 percent of all homeowners over the age of 62, but comprise nearly 60 percent of all people with a HECM loan. The study suggests that HECM borrowers tend to have more limited incomes than other people their age. Borrowers on fixed incomes may need a reverse mortgage to provide a financial cushion against increasing expenses, to pay for home repairs and property taxes, for travel and other leisure activities, and for other purposes including long-term care. In HUD's focus groups of HECM borrowers, participants reported being attracted to reverse mortgages because the loan allowed them to maintain their quality of life while remaining in their home.²⁷ However, because a reverse mortgage can be an expensive way to finance these needs, it may be most attractive for people with few other alternatives.

Long-Term Care Insurance

Long-term care insurance is designed to protect individuals against much of the financial risk of long-term care (LTC). LTC services focus on maintaining and improving individuals' ability to function day-to-day. Generally these services are not considered medical care and thus are not covered by most private health insurance policies and Medicare. Such services can be provided in nursing homes, in the elder's home, in assisted living sites, or other locations such as adult day care centers. LTC can be either skilled or non-skilled. Examples of skilled care include physical therapy or wound care. Non-skilled care includes help with

²⁵ HUD, "Refinancing Premium, National Loan Limit, and Long-Term Care Premium Waiver for FHA's HECM Program," 2003.

²⁶ HUD compared its HECM data to a 1997 survey by HUD sampling the general population of homeowners.

²⁷ From focus group results conducted as part of the 2000 HUD evaluation report.

activities of daily living (ADLs), such as bathing, or homemaking activities.²⁸ Unlike health insurance, LTC insurance policies are not often provided as an employee benefit and are not available to individuals who already need services or who have specific pre-existing conditions.

What LTC Insurance Covers. Generally, a LTC insurance policy:

- Covers services aimed at improving functioning: LTC insurance benefits include services aimed at helping patients with ADLs.²⁹ These services vary by policy but generally include: nursing care; speech, physical, and occupational therapy; homemaker services; hospice care; and caregiver training and respite care. Medical services like prescription drugs are not usually covered by LTC insurance.
- Promotes patient involvement in care: Services are often provided through a physician-directed care plan. There may be a patient advocate to help claimants make wise choices about how to use their policy benefits. Patients decide when they need care, and must seek it out.
- Specifies settings where services will be covered: LTC policies often specify in which settings (nursing homes, assisted living facilities, or in the home) they will pay for services. Policyholders can select policies with comprehensive coverage (in all settings) or those that just cover help at home or in a nursing home.
- Limits payment per day or month: Some policies will cover different amounts of care per day, depending on the setting in which the care is provided. For example, a policy with a \$100 a day limit might contribute \$100 to a nursing home day, but only 75 percent of \$100 if the care is provided in the home. The \$25 difference between the daily limit and the coverage for in-home care is often credited to the policyholder, effectively extending the length of the policy.³⁰ Other policies might cover up to \$100 a day in care no matter where or by whom the care is provided. If a day of nursing home care costs more than the \$100 daily amount provided by a policy, policyholders must pay the difference with their own resources.

²⁸ Activities of Daily Living (ADLs) include: dressing, bathing, eating, mobility, housekeeping, and continence.

²⁹ Eligibility for benefits for most qualified LTC policies is triggered by when a policyholder needs help with two or more ADLs, although some policies will also begin coverage when a policyholder has dementia, or when a physician certifies that LTC is needed.

³⁰ This is called the “pool of money” approach, wherein the policyholder can use the money his policy provides (subject to the daily limits) in whatever setting he chooses. This means that some policies which are limited to 3 or 4 years may actually pay benefits for a longer period when the daily limit is not maximized during the 3 or 4 year period.

- Caps payments over time: Generally, policies only pay benefits for a fixed period of time, generally for 3 or 4 years, although consumers have the option to purchase less coverage or lifetime coverage (with any partially used days of care increasing those limits).
- Includes waiting periods: LTC insurance is not first dollar coverage, in general. Most policies sold have a waiting period, of 30, 60, or 90 days from when a patient first begins receiving LTC services until the policy will begin paying for these services.

Options for Consumer Protection. LTC insurance policies often offer additional options to improve the benefits they provide. Two examples are inflation and nonforfeiture protection. Because LTC insurance is a product that is purchased far in advance of its use, its benefit amounts risk being insufficient if not adjusted for inflation in the cost of health care. The amount of the daily benefit in a policy without inflation protection will not change over time, even as the cost of health care increases. This type of policy would require the policyholder to pay out-of-pocket an increasingly larger share of the cost of care over time.³¹ Policies that include inflation protection are more expensive but help ensure adequate coverage when the benefit is ultimately needed. A second type of option protects people who lapse (due to missed payments) or cancel their policies before ever using them.³² This is called nonforfeiture protection, and it generally adds to the premium amount. Under this option, people no longer paying LTC insurance premiums receive some part of their premium investment in a “paid-up” benefit. For example, a person with a 3-year policy benefit who stops paying their premium may be eligible for a 1-year benefit instead. A related option called “contingent nonforfeiture” allows policy holders to downgrade their benefits in the event that their insurer raises their premiums significantly and the policyholder cannot afford the new premium amounts.³³

LTC Insurance Premiums. LTC insurance, similar to disability and life insurance, is a mechanism to pre-fund the future costs of long-term care. Thus the premium level is set at the time of purchase of the policy and generally does not change from year to year like in the health insurance market.³⁴ A number of factors affect the amount of the premium. The type of benefits and policy features chosen clearly affect the cost – the

³¹ An inflation protection option increases the amount of the daily benefit (and thus the lifetime benefit limit) by either simple or compound inflation, usually 5%. Policies with a simple inflation option increase the benefit amount by the same value each year (e.g. by \$10 a year). Compound inflation policies increase the benefit amount by a set percent each year of the previous year’s amount.

³² Some policies contain a feature wherein the insurance company will notify a third party (e.g. a relative) if a policy is in danger of lapsing.

³³ LTC insurance premiums are not expected to change regularly. If there is a sharp increase in the premium amount the policyholder has the option to change the benefit amount (downgrade), convert to “paid up” status, pay the new premium amount, etc.

³⁴ LTC insurance premiums are not expected to change annually. LTC insurers may raise their premiums only in certain circumstances, such as to cover dwindling reserves, as allowed by state regulations. In the past, some insurers have increased rates dramatically. In these cases, policyholders have several options (see footnote 33).

more generous benefits and better consumer protection options increase premium amounts. In addition, premiums reflect the age and sometimes the medical condition of the individual at the time of purchase. Premiums for the same policy are lower for younger applicants since they are expected to pay premiums for more years before needing services than older applicants are. Likewise, many insurers underwrite policies to reflect the health status of the applicant, with patients at risk for illness offered policies with higher premiums (or not offered a policy at all). Lastly, premiums vary from insurer to insurer and amongst the various plans the insurers offer.

The following table shows how premiums vary by plan and age in the Federal Long Term Care Insurance Program. The basic plan pays for care in a nursing home or assisted-living setting, whereas the more comprehensive plan allows beneficiaries to receive care in a variety of settings. The premium amounts are for a policy with a 3-year benefit and a \$100 a day benefit limit.

	Plan Type	Monthly Premium
Age 50	Basic Plan	\$40
	Comprehensive Plan	\$60
Age 65	Basic Plan	\$80
	Comprehensive Plan	\$120
Age 79	Basic Plan	\$250
	Comprehensive Plan	\$340

The LTC Insurance Market. A fairly large number of insurers offer LTC insurance products, although 80 percent of policies were sold by just eleven companies in 2001.³⁶ State legislation and regulation influences the type of products available from state to state. Regulation of LTC insurance is variable, with some states having stricter consumer regulations than others. The LTC insurance market is concentrated in a few states, with half of all sales in only ten states.³⁷ The recently-launched Federal Employee Long Term Care Insurance Program allows chosen insurers to sell individual, partially underwritten policies via the government to

³⁵ Premium amounts from www.ltcfeds.com, accessed 12/09/2003.

³⁶ HIAA, "Long-Term Care Insurance in 2000-2001," January 2003.

³⁷ Those states are: California, Florida, Illinois, Iowa, Missouri, New York, Ohio, Pennsylvania, Texas, and Washington. *ibid.*

Federal employees and their relatives, opening up a major new market. To date, over 200,000 policies have been sold through this program.³⁸

Low but Growing Number of LTC Insurance Policy Holders. Despite public and private efforts, only about 5.8 million people had active LTC insurance policies in 2001. A number of explanations have been offered for the limited enrollment. LTC insurance, especially if purchased later in life, can seem expensive. People may have the misconception that Medicare will pay for their LTC needs or believe that they can qualify for Medicaid and still protect their assets.³⁹ They may not be able to recognize the value of LTC insurance in the future – or may not want to confront the possibility that they will no longer be able to take care of themselves. In addition, most employers do not offer or subsidize the cost of LTC insurance. Interest by employers has been increasing in recent years, however.

Who Buys LTC Insurance. The average age of a purchaser of LTC insurance was 67 years old in 2000, and a third of all policies are sold to people under the age of 65, according to a Health Insurance Association of America (HIAA) survey of LTC insurance purchasers and non-purchasers.⁴⁰ The study reported that purchasers of LTC insurance believed they were at risk for needing LTC more than did people who chose not to purchase insurance, and were less likely to believe the government or health insurance would pay for their LTC needs. According to the survey, about one-third of LTC insurance buyers wanted to protect their assets and estate by insuring against the need to spend their estate on their long-term care needs, and nearly half thought that the tax deduction was an important incentive in making purchasing decisions. The study also reported that non-purchasers felt that LTC insurance was too costly or too confusing for them. Beyond this study, other factors may discourage enrollment. Individuals with an illness or disability usually cannot purchase LTC insurance even if they want it. For those potentially eligible for Medicaid, LTC insurance may be inappropriate. Still others may be unaware of the “cost” of being unprepared for long-term care costs.⁴¹

Linking Reverse Mortgages and Long-Term Care

In 2000, Congress passed a provision, which has yet to be implemented, within The American Homeownership and Economic Opportunity Act of 2000 to encourage a link between reverse mortgages and long-term care insurance. Specifically, the law waives the up-front premium on government-insured reverse

³⁸ Telephone conversation with John Cutler, at the Office of Personnel Management, December 17, 2003.

³⁹ States are required by law to recoup the assets from deceased Medicaid beneficiaries for LTC services received and limit Medicaid payments for those who have attempted to shelter assets in order to “spend down.” In the past, the home was viewed as protected from recovery by Medicaid, but several states now put liens on homes after a Medicaid beneficiary has died.

⁴⁰ HIAA, “Who buys Long-Term Care Insurance in 2000?” 2000.

⁴¹ For those without insurance, LTC can be so expensive that people may not have enough income or assets to pay for it without leveraging their home. For those who spend down to Medicaid, they may also lose their home. The Omnibus Reconciliation Act of 1993 requires states to conduct estate recovery for the costs of Medicaid-paid benefits for those over 55 receiving LTC services; some states conduct estate recovery by placing liens on homes.

mortgages for homeowners who use 100 percent of the money from their reverse mortgage to purchase a qualified LTC insurance policy.⁴² This premium equals two percent of the home value.⁴³ The 2000 HUD study indicated that the median home value of those participating in the HECM program was just over \$100,000; so the average value of the premium waiver is expected to be around \$2,000. The new law defines a qualified LTC insurance policy as one that adheres to criteria in the Internal Revenue Code and several of the National Association of Insurance Commissioners (NAIC) LTC insurance regulations (e.g., nonforfeiture protection).⁴⁴⁻⁴⁵ To implement the law, the government needs to develop rules for how the incentive will work. Policy makers expect the regulations needed to implement the law to be issued in the Spring of 2004, suggesting that this option could be available to individuals beginning in 2005.

Using a reverse mortgage to purchase long-term care insurance has the potential to help protect peoples' retirement savings, limit the financial responsibility of the Federal and State governments, and provide care options suited to the individual needs of the elderly. However, neither a reverse mortgage nor LTC insurance is right for everyone. Listed below are key issues raised by the linkage.

Mismatch in Reverse Mortgage and LTC Insurance Timing. Currently, the average age of a person getting a reverse mortgage is 75 years old, while the average age at time of purchase of a LTC insurance policy is 64 years old. People cannot even qualify for a HECM until they are 62 years old. The optimal time to buy a LTC insurance policy is not necessarily the optimal time to take out a reverse mortgage, and vice versa. LTC insurance is the least expensive for people who are relatively young, in their fifties and younger. People who wait to purchase a LTC policy until their 70's may find that they are no longer medically-eligible. However, reverse mortgages provide more equity and cost less (less interest) to older homeowners (in their seventies). More equity provides more assurance that the monthly LTC insurance premiums would be affordable over time. And some mortgage types might not be appropriate vehicles for funding LTC insurance (e.g., with a

⁴² The mortgagors are allowed to use some of the money to pay the closing costs on the loan and still qualify to avoid paying the HECM insurance premium.

⁴³ In some areas, the home value is greater than the county loan limit, so that the premium in some instances might be less than 2% of the home value (it would be 2% of the loan limit for that area.).

⁴⁴ A 1996 law, the Health Insurance Portability and Accountability Act, allowed special tax treatment for premiums for certain types of LTC insurance policies. These criteria for determining whether a policy is qualified are listed in Section 7702B of the Internal Revenue Code.

⁴⁵ NAIC develops model insurance laws and regulations, which many states adopt for their citizens. LTC insurance policies would have to comply with Sections 8, 9, 24, and 26 of the NAIC regulations promulgated in September of 2000. Sections 8 and 9 of the NAIC regulation require disclosure by insurers to consumers about their rating practices, benefit triggers, and renewability. Section 24 requires insurers to develop suitability standards. Suitability refers to whether LTC insurance is appropriate for the policy applicant. Section 26 deals with nonforfeiture and contingent benefits if policyholders lapse on their payments. Nonforfeiture is an aspect of LTC insurance that protects a policyholder from losing all of the value of the premiums they have contributed if they fail to continue to pay premiums. In that case, they would be eligible for a more limited benefit.

term reverse mortgage, LTC insurance premiums may outlast the monthly mortgage payments). Using a reverse mortgage to fund LTC insurance may make sense for certain age groups and not others.

Mismatch in Reverse Mortgage and LTC Insurance Target Populations. Results from the 2000 HUD evaluation of the HECM program indicate that reverse mortgage borrowers tend to be single, low-income, and have few assets other than the home. These people may not be able to afford LTC insurance even with a loan, and may value LTC insurance less than someone with a spouse and significant assets to protect would. To date, most purchasers of LTC insurance have been in middle to upper income households, with resources to purchase LTC insurance without needing to borrow the equity in their home. There may be very few people for whom this policy makes sense.

Exclusive Use for LTC Insurance. Under the new law, homeowners cannot use the equity in their home for anything but LTC insurance premiums. They cannot set aside funding for the costs of LTC services above the daily limit of their policies and for the services they need during the policy's waiting period. In order to save roughly \$2,000 on the reverse mortgage up-front insurance premium, they must give up a great deal of flexibility in the use of this major asset. This feature of the law may discourage many people from participating in this program.

Conflicting Products. Currently, people who take out reverse mortgages are required to maintain that home as their primary residence. This would indicate that individuals who become residents of a nursing home or an assisted-care facility for a certain period of time might be required to sell their home. On the other hand, only some LTC insurance policies pay for care provided in the beneficiary's home (these generally cost more than policies that cover care in a nursing home). The law is not clear as to how this conflict will be handled, but perhaps the regulations will clarify this.

Policy makers may also have concerns about how the implementation of this policy will proceed. The following list demonstrates the complexity of administering a program linking two privately-purchased, complex products.

Consumer Protections in LTC Insurance Policy. Policy makers and consumers must have confidence in a program that, in essence, trades seniors' homes for LTC insurance. Beyond what is in the law, the regulation could include consumer protections such as: protections to ensure that premiums remain affordable to policyholders (contingent nonforfeiture); help for policyholders whose insurer goes out of business;⁴⁶ and

⁴⁶ This is a state issue, since states are the primary entities involved in regulating insurance policies and companies. Because LTC insurance is pre-funded, there is concern that policyholders might lose their investment if an insurer were to go out of business. States are currently active in this area, requiring insurers to maintain a certain level of cash reserves, among other requirements.

LTC insurance policies that allow people to remain in their homes while receiving care (LTC policies that cover care in the community). In order to address these concerns, the regulation could add other minimum standards to the list of qualifications for LTC policies.

Consumer Counseling. Currently, those who apply for a HECM undergo a mandatory counseling process to determine if a HECM is right for them. Generally, purchasers of LTC insurance also receive counseling on the myriad plan features available to them. The new law requires a linkage of these counseling efforts, although it is unclear who will be conducting this counseling. As it now stands, neither reverse mortgage lenders nor LTC insurance brokers know the others' business. Because the law limits eligible LTC insurance policies to those qualified under the NAIC regulations, at a minimum, the government should create a mechanism to prevent the purchase of a non-qualified LTC insurance policy by those seeking to waive the HECM insurance premium.

In addition, the government should ensure that effective counseling is offered. The result of the counseling process should be a determination of the appropriateness of the link for the individuals concerned. Those not eligible for LTC insurance or who may be eligible for Medicaid should be aware of this before they apply for a HECM. Conversely, people with limited equity and other income may not have the means to pay LTC insurance premiums for many years before needing LTC (unless they get a tenure loan). Some individuals may need more flexibility in the use of the payout from their reverse mortgage. For these populations and others for whom this linkage is not appropriate, different public policies will be needed to address their LTC insurance financing challenges.

Administering the Link. Systems would ideally be developed to ensure simultaneous approval for the reverse mortgage and LTC insurance. This prevents individuals from getting an insurance policy without the reverse mortgage funding or paying for the closing costs on a loan and then finding that they are ineligible for LTC insurance. Administering, monitoring, and enforcing the linkage should be a priority since the products are highly complex and consumer knowledge is limited. In addition, administration of the policy will be complicated by the fact that some states have not adopted the NAIC rules. In these states, LTC insurance policies may be offered with different consumer protections and insurance regulators might not have the expertise to determine if a policy is "qualified". In all states, it is unclear which entity will be charged with making this determination – a state health insurance program (SHIP), another state agency, the insurer, or the lender.

Outreach. To achieve its goals, the policy would have to address the current limited popularity of both reverse mortgages and LTC insurance products. As the policy now stands, it has no educational component. An educational campaign should accompany the law's implementation to explain the two complex products.

Conclusion

Linking reverse mortgages to long-term care insurance was inspired by the need to better prepare the near-elderly and elderly for the cost of long-term care. It offers the possibility of using home equity – often this group’s most significant financial resource – to pay for this care. This reverse mortgage-LTC insurance idea has a long history and, with the new law promoting it, will receive its first real test. Both the soundness of the idea and the details of its implementation will affect its success. As discussed in this issue brief, elements of reverse mortgages and LTC insurance are at odds with each other. These products differ in when they are best purchased and who purchases each. The policy itself could discourage enrollment through its restricted use of the reverse mortgage funding and its lack of assurance that participants will not lose their homes due to participation. The details of its implementation matter as well. The regulation’s level of consumer protections and education, administrative simplicity, and outreach will affect both participation and satisfaction. This project will track the implementation of the reverse mortgage-LTC insurance policy and offer concrete suggestions on how it, along with other public policies, can help improve the financing of seniors’ retirement and health needs.