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Long-Term Care versus Disability Insurance: Which is Right for You?

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By Jim Mooradian and Chris Allen

While your company very likely offers disability insurance as a core benefit for employees, it's less likely that long-term care (LTC) insurance is on the menu, even as a voluntary benefit. With America's population aging, benefits managers are fielding more requests to look at LTC programs. Most Americans need income replacement for their paycheck above all else, while long-term care policies fill a more targeted need for asset protection during a person's retirement years. This article focuses on the advantages and disadvantages of each type of insurance, and explores why your company might want to consider offering long-term disability (LTD) and long-term care (LTC) coverage in its benefits package, either as part of core offerings or through a menu of voluntary benefits, depending on the ages and life stages of your employees.

What is prompting employee interest in LTC insurance? If your employees have elderly parents or are approaching retirement age themselves, they may be asking questions about LTC programs because they've heard that a stay in a nursing home can cost up to $11,000 a month. They may also have heard the stories about or experienced firsthand the economic devastation caused by a stay in a nursing home, whether anticipated or unexpected. These statistics and experiences have led to a boom in the market for long-term care policies over the last ten years.

At the same time, more families are living paycheck to paycheck and worrying about the financial and emotional impact of breadwinners getting so sick or hurt that they are unable to work, prompting questions about their need for disability insurance.

Thus, many Americans are wondering whether they should purchase long-term care insurance or disability insurance. As a benefits manager, you can help employees understand why this isn't necessarily an either-or question, and provide them with objective information about when and why LTC and disability insurance policies are appropriate for a person's particular circumstances.

LTC and Disability Basics

When employees purchase any form of insurance coverage, it's important that they understand the exposure they are attempting to cover and the benefits of the proposed policy. A long-term care policy pays a monthly benefit in the event an employee is unable to perform two of the six activities of daily living, which are: eating, bathing, transferring (ability to move around), toileting, dressing, and maintaining continence. LTC policies typically provide benefits for between three and six years, though lifetime benefits are available under some policies.

Disability insurance offers income replacement in the event an employee gets sick or hurt during their working years. A disability policy will typically pay a monthly benefit until age 65 in the event a person is unable to perform the duties of his occupation. Because most Americans are living paycheck to paycheck today, disability insurance is an extremely important security product. Many advisors feel it is one of the foundations of a solid financial plan.

One of the positive aspects of disability insurance is that the policy language is favorable to the consumer, with policy definitions that typically cover a person unable to do his or her job because of accident or sickness. These policies also usually cover partial disability in the event an employee is working on a less than full-time basis, but is still able to do some aspect of the job. An individual disability contract can also have a fixed guaranteed premium, and the coverage is totally portable and cannot be canceled or changed by the carrier. This provides a great deal of security to the consumer.

Which Type of Policy to Choose?

The question becomes, which one of these two types of policies is more appropriate for a given employee, and when? If an employee is actively working and relies on that income to provide for himself or his family, it is likely that a disability income policy would be more appropriate than an LTC policy. Recent studies have indicated that 75% of families cannot go more than a month without a paycheck before they have trouble meeting their financial obligations.

The list of all the things that could preclude people from performing the material duties of their job is much longer than the list of things that leave them unable to care for themselves. This is the essential difference between the definitions in the two types of insurance contracts. For example, while a heart attack may leave a person unable to perform certain occupations, it is unlikely to render him completely unable to care for himself. If a 50-year-old man could no longer work due to a heart condition, but owned a long-term care policy, he would have no income, no claim dollars from his LTC policy, and would still need to pay the premiums for that LTC contract.

The definitions in a disability contract cover long-term care scenarios, but not vice versa. If the same 50-year-old man referenced above suffered a stroke and was in a coma, his disability income policy would pay a monthly benefit. But if he just had a bad back and an LTC policy, the LTC policy would likely not provide him with any benefits; he would find it much easier to be on claim under a disability policy.

Unfortunately, we see too many people in their working years who are without enough disability insurance coverage, but who are paying premiums for a long-term care policy. Educate your employees to closely scrutinize the value of a premium dollar, and to use those premium dollars in the most appropriate manner to cover the biggest exposures. Your company can help educate employees so they don't purchase the wrong contract to cover the wrong situation.

The insurance carriers themselves have recognized when a certain type of coverage is appropriate. Many of them now sell disability policies that have conversion provisions to a long-term care contract built into the policy. Suppose, for example, that a man buys a disability policy at age 45. At any time between the ages of 60 and 70, he can convert that policy on a guaranteed basis, without medical questions, to a stand-alone long-term care policy. He now has disability coverage through his working years, when protecting his income is vital. Then, upon conversion as he nears retirement, he can obtain a policy to protect his assets in the event he requires long-term care.

LTD/LTC "Hybrids" Available

Over the last ten years, we have seen a large increase in the number of long-term care policies sold. We are also now seeing a greater amount of volatility in those premiums, which are not guaranteed. In fact, most LTC carriers have increased their rates by 60% in the last three years. In the same timeframe, we have seen the disability marketplace become increasingly restrictive, certainly with respect to underwriting. While it can be harder to get these policies, the benefits for the policyholder are stronger and the premiums are guaranteed.

Some modern disability contracts also carry a long-term care rider, or catastrophic rider, on top of the disability benefit in the event of a severe accident or sickness. This can be a great way to cover severe claim situations, at least through a person's working years, typically to age 65 or 67. In some respects, the existence of a long-term care rider on a disability policy is making LTC policies somewhat redundant. However, long-term care insurance still makes sense for people who no longer need disability insurance or income replacement.

LTC policies are most appropriate for asset protection as a person approaches retirement. Long-term care policies are easy to understand and allow employees to purchase a plan that provides a daily benefit for a certain duration. The definitions for claims are clear-cut. The underwriting for these policies has been a little easier than in the disability marketplace, which has led to younger people purchasing LTC insurance.

One other key fact about long-term care policies is that they do not carry a fixed premium and are "renewable." As a result, we have seen rate adjustments by most carriers twice over the last five years, one quite recently. Although the pricing on these LTC policies is volatile, that doesn't diminish their value – they may just be more expensive than originally anticipated.

Educate Employees to Make Better Choices

We remain supporters of long-term care if it is purchased correctly and for the right reasons, because the financial liability of being in these severe claim situations can be devastating to families in retirement. That said, many individuals purchase LTC coverage when their real need is additional disability insurance. We contend that most Americans need income replacement while they are working due to the fact that the majority live paycheck to paycheck and could not meet their obligations if a disability occurred.

All too often, however, employees don't understand these two types of coverage or why they might need an LTD or LTC policy. By educating your employees about these products – even if they are available only as a voluntary offering – you can help increase employee satisfaction and loyalty. Offering employees the option of purchasing these benefits through the company allows them to access advantages they couldn't duplicate on their own (such as guaranteed underwriting and premium discounts). Just as importantly, educating employees gives them the tools they need to make sound financial choices. When your employees understand the differences between long-term care and disability policies, they are better able to choose the product that fits their age, stage of life, and financial situation.