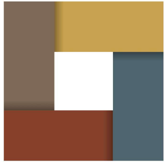

Caring for Your Future: Understanding Long-Term Care

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The Administration on Aging estimates that over 60% of people who are 65 today will use some type of long-term care (LTC) support service. The cost of these services can be significant. A 2022 Congressional Research report concluded that Americans spent a combined $475.1 billion on LTC services and support in 2020. Since traditional health insurance policies and Medicare do not cover LTC related costs, recipients of care must either cover costs on their own (self-insure) or rely on insurance benefits to fund their care. For this reason, it is critical to understand the different approaches to plan and prepare for this risk.

History of LTC

Long-term care insurance can trace its origins back to the 1960s. As nursing home utilization rates increased substantially, many Americans found they could not afford the exorbitant costs without having to sell their homes or raid their retirement savings. Seeing an opportunity, insurance companies began writing policies to specifically cover these expenses. The original policies were generous. It was common to see contracts with lifetime coverage and compounded payment increases of 5% annually. Policyholders paid an affordable premium on the policy, and the unfortunate few who needed nursing home care were able to afford private facilities.

Long-term care insurance policies generally reimburse for expenses up to a set daily limit for services related to assistance with activities of daily living (ADL). These activities include bathing, eating, dressing, transferring/ambulating, and using the toilet. Most policies will cover care provided in a nursing home or assisted living facility when the insured cannot independently perform two of the six ADLs. Some policies may also include in-home care, or other forms of assistance.

Source: Administration for Community Living

By the early 2000s, insurance companies began to realize the financial mistake they made. Nursing home care and new assisted living facilities were rapidly replacing in-home care by family members. Coupled with rapidly rising costs of care and increasing longevity of the general population, claim obligations were exceeding actuarial cost expectations. To combat financial strain, insurance providers began drastically hiking up premiums (From 2005 to 2015, LTC premiums increased by around 40%) and reducing benefit payouts though more restrictive requirements, maximum payout limits, and bureaucratic claims processes. Even with these adjustments, most providers found they could not offer policies in their traditional structure profitably. The result has been a significantly diminished landscape of providers – the number of insurers offering LTCI coverage has decreased from slightly more than 100 in 2004 to only about a dozen today.

With insurance offerings continuing to evolve, many policies offered today are designed to combine coverage for long-term care with another benefit--typically life insurance and in some cases annuities. The concept is straightforward: the insurance company offers “early access” via long term care benefits to benefits it is already obligated to pay under life insurance or annuity plans, making a combined policy more predictable than stand-alone LTC coverage.

Self-Insuring vs. Purchasing a Policy

As is the case with all insurance, the appropriate strategy differs for each person. For some, a long-term care policy offers a psychological peace of mind that may be invaluable. For example, an individual may have more than enough wealth to self-insure but wants to avoid any situation where the quality of their care is diminished in order to preserve assets for inheritance. It is important to talk to an advisor and determine if unique non-financial factors require additional insurance or estate planning.

Average Duration of Private Facility Care: 2.5 Years (U.S. Department of Health and Human Services)

Average Annual Cost of Private Facility Care: $108,000 (Genworth Cost of Care Survey)

Average Age of Long-Term Care Claimant: 80 (American Association for Long-Term Care Insurance)

For most, the analysis is more mathematical and can be approached through practical examples. To be conservative and match the goals of our clients, we draw on statistics from affluent individuals seeking high quality care. Today, an individual in this group would need roughly $270,000 ($108,000 x 2.5) to cover the average expense scenario. Assuming this 80-year-old individual decided at age 50 to self-insure, they would have needed to invest roughly $260/month earning 6.50%. Put another way, if an insurance company believed they could invest and earn a minimum of 6.50% annually over 30 years, then $260/month could be a reasonable starting point for setting premiums.

Statistically speaking, the experience of most people will fall somewhere near this average scenario—in which case neither the insurance company nor the insured will benefit in a material way from one another. For the unfortunate minority of people who require care much younger and/or exhaust maximum benefit limits, insurance coverage would certainly be of financial benefit. For those who require less care, or the estimated 40% of older adults that will not require care at all, insurance coverage would come at the highest cost. For example, if the individual in the previous scenario was able to achieve 8.00% annual returns as opposed to 6.50%, they would have an *additional* ~$120,000 for themselves or posterity.

While it is impossible to predict one's future, we generally believe it is preferable for those who can afford to self-insure to maintain control over money that would otherwise go to premiums. The additional flexibility and financial upside are invaluable and outweigh the potential benefit of coverage. Of course, each situation is unique and as your dedicated wealth management team, we are always ready to review pre-existing policies and/or explore strategies that are customized to clients' needs and circumstances.

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