

The Signalert Scoop

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May 12 2016



Long Term Care Insurance: Part I Pros and Cons

By Dr. Marvin Appel, President
Signalert Asset Management

What is long term care insurance?

Long term care insurance reimburses policyholders a daily amount (up to a pre-selected limit) for services to assist them with activities of daily living such as bathing, dressing or eating. The payments can cover costs associated with an aide who helps you live at home or can be paid towards the cost of living in a facility such as assisted living or a nursing home. Most new policies have a lifetime limit on the amount of money you can collect, typically limiting you to approximately six years of benefits. For an added cost you can purchase a policy where the amount of the daily benefit increases each year to keep up with inflation. Although many long term care policies have gone for years without increasing the premiums, you should be aware of the terms in the policy you are considering that do permit the insurance company to raise its rates. On occasion, past rate increases have been very steep.

Long term care insurance is a hot topic in the financial planning world. But is it right for you? This article will briefly review some of the points for you to consider.

How much can you expect to receive from your long term care policy?

Approximately 40% of long term care policies pay out benefits. Of these, the average length of time is one and a half years. (Note that 70% of people will have a long term care event, but not all of these people would have been accepted as insurance customers because of high pre-existing risk.) One policy that I was offered paid \$180,000/year (with inflation adjustment available for extra cost) for a maximum of six years. That means that the average benefit paid to those who make a claim is \$270,000. Since 40% of policies pay a claim, the average return to a long term

care policy holder is \$108,000 in current dollars. (That is, 40% chance of making a claim times the \$270,000 average claim.) The maximum benefit is \$1,080,000 (which is six years times \$180,000/year).

How much should you pay for this benefit?

The premium I was quoted at age 52 was \$5,000/year, which I would expect to pay for 25 years before making a claim. That means that if my experience is average, I will pay \$125,000 in total premiums for an expected benefit of \$108,000.

If instead of buying the insurance, I invested the \$5,000/year at 3%/year return then I would end up with \$182,296. The difference between the expected benefit (\$108,000) and the present value of the expected premiums paid (\$182,296) is the profit for the insurance company. Even though insurers have been reluctant to increase premiums, there have been significant premium increases on some policies in the past.

Should you sign up?

As with any insurance, you should expect to receive fewer benefits from the insurance company than the value of the premiums you pay. The question for you is whether the reduction in risk (having to pay for your own long term care) is worth the expected cost. There is no single correct answer that suits everyone.

The decision to buy long term care insurance depends on your individual circumstances. I view long term care as a reduction in income that you use to buy insurance against spending some of your accumulated assets (which you might otherwise have to spend on care). As a general rule, people whose income is high relative to their savings can best benefit from the insurance. On the other hand, people with high savings relative to their incomes (or with very undependable incomes) should tend to avoid taking on the fixed commitment of a long term care premium.

Also note that if you are able to live at home with assistance, generous government benefits are available through a program called “community Medicaid”. You don’t have to be broke to claim these benefits, but you do need the assistance of a qualified elder care lawyer to fully protect your assets.

Disclaimer: Signalert does not offer tax advice. We recommend that you consult with your investments, tax and/or legal advisors before acting on any recommendations in our Scoops.

FYI

At least 70% of people over 65 will need long-term care services and support at some point in their lives. *

At a median daily rate of \$240, an average nursing home stay of 835 days currently costs over \$200,000. (The average hotel room is just \$121/day!)*

*www.lifehappens.org

Signalert

Asset Management

Registered Investment Advisors

525 Northern Boulevard, Suite 210
Great Neck, New York 11021
516-829-6444

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For personalized investment management or financial planning, please contact us at:



Signalert Asset Management LLC

Email: clientservices@signalert.com

Web: www.signalert.com