



Health and long-term care costs could take big bite out of retirement savings

By Malcolm Cheung, vice president of Long-Term Care Insurance for Prudential (published in *Broker World*, May 2010)

The key to managing risk is making informed choices. If you know what a hornet's nest looks like, chances are you're not going to pick it up for a closer look. On the financial front, you probably wouldn't buy a home or car without first calculating whether you can afford it.

The same logic applies to long-term care. Americans are living longer and rightly worry about the cost of home health care, assisted living facilities and nursing homes should they become incapacitated for an extended time in retirement. But many people don't have an accurate picture of their true exposure -- and that has implications for how prepared they are to meet these potential costs.

New research suggests that in extraordinary cases long-term care costs can quickly overwhelm retirement savings for all but the wealthiest households. "What is the Distribution of Lifetime Health Care Costs from Age 65," a new study by the Center for Retirement Research at Boston College found that a typical married couple can expect to pay, on a present value basis, \$197,000 in out-of-pocket health care costs from age 65 until death, mostly Medicare and private insurance premiums, co-payments and uninsured expenses. That number rises to \$260,000 when nursing home costs are included.

But average costs don't tell the whole story. The study, underwritten by Prudential, found the typical household faces a 5 percent risk that the present value of uninsured health care costs could exceed \$311,000 in retirement—or more than \$570,000 with nursing home expenses thrown in. For perspective, the Center for Retirement Research estimated that less than 15 percent of households approaching retirement had accumulated that much in total financial assets—and that was at the stock market's peak in 2007.

The study also found that lifetime health care costs ebb but remain substantial at advanced ages. At age 85, for example, couples face an average remaining lifetime cost of \$203,000, factoring

in nursing home expenses, with a 5 percent chance the number could balloon to more than \$477,000.

What does this mean for brokers and other financial professionals? The magnitude of potential long-term care costs can be devastating. Many clients can benefit from a timely, frank discussion of the issues so they can tailor a plan that incorporates their specific needs and risk tolerance. As part of the process, financial professionals should:

—**Clear up misperceptions.** The average American who reaches age 65 has more than a 60% chance of needing some form of extended care in their lifetime, government statistics show. Yet one-third of U.S. workers say they either do not expect to need long-term care or lack a plan if the need does arise, according to Prudential's 2009 Benefits & Beyond annual survey of employee benefit plan participants.

So how is the tab going to be paid? Many clients aren't aware that Medicare will pay only for skilled nursing home expenses in the short period following hospitalization. Medicaid, which provides health care coverage for the poor, does pay almost half of the costs for nursing home care. But most people would not be eligible for the program until the bulk of their financial assets are depleted.

That may not take long: the average annual cost for a semi-private room in a nursing home was \$70,810 while a room in an assisted living facility averaged just under \$40,000 a year, according to a 2008 long-term care cost study by Prudential. Furthermore, the rate of increase in nursing home and assisted living facility costs between 2006 and 2008 exceeded the rate of increase in the consumer price index. Employing a home health care aide for just 20 hours a week, by comparison, costs \$22,000 a year.

—**Identify assets that can be used to offset health care costs.** Many workers say they expect to tap their 401(k)s or personal savings for unanticipated long-term care costs in retirement. Yet there are other options that may hold promise, particularly if workers get a start well before retirement. Health Savings Accounts, which offer tax advantages provided funds are spent on legitimate health care expenses (including long-term care insurance premiums), are one way to go. So are annuities that offer guaranteed income but still allow access to underlying funds when an emergency arises.

If assets aren't expected to be sufficient to pay for future health or long-term care costs, a client may want to consider working beyond normal retirement age.

—**Explore insurance options. Long-term care coverage is one way to protect retirement savings, although no policy covers every expense.** Although many people may want to defer the purchase of long-term care insurance until they are older and retired, that may not be the best decision. Premiums are lower for those who apply for coverage at a younger age. And actively-at-work employees enrolling in a plan sponsored by their employer can usually get coverage with no or limited medical underwriting,

A disconnect seems to exist between workers' interest in long-term care and the writing of LTC policies, which suggests a pent-up demand. Some 53 percent of employee benefit plan participants rated long-term care needs as "highly important" in Prudential's annual survey last

year, up from 40 percent in 2007. Yet only 8 percent of workers participated in group long-term care plans if one was offered by their employer. Another 5 percent purchased LTC coverage outside the workplace.

Medigap coverage can help offset health costs that aren't long-term care in nature and aren't covered by Medicare or other plans.

—Reassess a client's plan from time to time, as circumstances and health change. Stock market fluctuations can shrink or swell financial assets earmarked for health-care costs. A decline in health either before or immediately after retirement can translate into heavier care burdens than originally anticipated. Regular financial check-ups can keep a client's long-term care strategy on track.

Next year, the first Baby Boomers will turn 65, sparking a demographic shift that should only give greater weight to long-term care issues. By 2030, the number of Americans age 65 and older will more than double to 71 million. Sound advice and counsel from brokers will help ensure that clients make clear-eyed decisions about savings, insurance protection and retirement security. By laying out worst-case scenarios, gauging risk tolerance and assessing a client's financial position, financial professionals can help shape retirement plans that will truly help their clients realize the retirement lifestyle for which they've worked and saved for so many years.

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