

## HOW TO SELF-INSURE THE LONG TERM HEALTH CARE RISK

Your insurance agent recommends that you buy long term care insurance because, if you need care, the insurance company will pay up to **\$3,000,000** to cover the costs – and, if you don't need care it will **refund** your premiums to your family when you die. In addition, since you pay New York State income taxes, you may be eligible to receive a **20% tax credit** on the premium payment.

You call Peter Smith, your financial planner, and ask him what he thinks. He says you don't need long term care insurance because you have “enough” money to “self-insure.”

You like Peter's advice because it means you don't have to pay another expensive insurance premium. But four months later you come across an article on Self-Insurance in Wikipedia\* that makes the following points:

- The **purpose** of Self-Insurance is that by **retaining** and **calculating** risks – and paying the claims or losses from captive or on balance sheet financial provisions – the overall process is **cheaper** than buying commercial insurance.
- If Self-Insurance is approached as a **serious** risk management technique, a **calculated** amount of money is **set aside** that will be sufficient to pay future claims.
- Normally, **catastrophic** risks are **not** usually self-insured as they are highly unpredictable and the potential loss is high.
- **100%** Self-Insurance is **rare** because a **combination** of self-insurance and commercial insurance usually provides the best risk management solution.

You decide you should do some more homework on the subject of long term health care and you come up with the following information:

- **20** out of every **100** Americans over age 65 will need long term health care for **six** or more years <sup>(1)</sup>.
- The annual cost of a nursing home in a large city can run up to **\$140,000** or more a year – and the average annual cost of 24/7 home care (such as might be required if care is needed as a result of a serious injury or stroke, or from illnesses such as Parkinson's and Alzheimer's) is **\$172,500**. You also learn that extended health care costs have been going up every year because of inflation so that this year's \$140,000 care cost can be \$306,000 20 years from now at a 4% CPI rate. <sup>(2)</sup>

With that information in hand, you put your calculator to work and come up with the following risk model based on the fact that the average length of Alzheimer's is 8 years.<sup>(3)</sup>

<u>Year Care begins</u>	<u>Annual Cost of Care</u>	<u>Total Cost of Care for 8 years<sup>(4)</sup></u>
2010	\$140,000	\$1,289,992
2030	\$306,000 <sup>(4)</sup>	\$2,819,553

You realize that if you really want to Self-Insure the long term health care risk you should earmark at least \$1,000,000 to cover potential costs, so you start looking at your assets to see where you can find it:

- You have \$450,000 in cash and cash equivalents – but you don't want to run through your cash accounts and have nothing left for emergencies.
- You have \$500,000 in mutual fund accounts but liquidating them could trigger capital gains taxes if you sell at a profit.
- You have a \$400,000 equity in your condo in Phoenix for which you paid \$650,000, but you certainly don't want to sell it at a loss.
- You have \$2,500,000 in your profit sharing and IRA accounts: but it takes a \$233,000 distribution to pay \$140,000 in care costs because it is 100% taxable as ordinary income. In addition, you have earmarked your retirement plan accounts to pay you income when you retire – not to pay an array of caregivers, therapists, and nurses.

Finally you understand that by self-insuring, **every** dollar you pay in long term health care costs is a dollar **less** for your family – **plus** the interest it would have earned for them. Therefore while Self-Insurance may be a sound risk management tool it results in asset **liquidation** rather than asset **preservation**.

You conclude that, because you had **not** set aside assets to pay for long term health care, nor did you want to, you were not self-insuring the long term health care risk – you were just **ignoring** it.

As a result, the long term care insurance policy your insurance agent had recommended – the one that will pay your costs if you need care, that refunds your premiums if you don't need care, and that is tax subsidized – is beginning to look like a very attractive alternative to “Self-Insurance”!

\* To read the full article “Self insurance” go to [http://en.wikipeida.org/wiki/Self\\_insurance](http://en.wikipeida.org/wiki/Self_insurance).

- (1) *What Can Current Retirees Expect?* Research by Peter Kemper, Ph.D., Department of Health Policy, Pennsylvania State University, June 2006 LTCI Sales Strategies Magazine. See also U.S. Department of Health and Human Services.
- (2) 2010 MetLife Mature Market Survey on the costs of long term health care.
- (3) The average length of Alzheimer's is 8 years. (See “Losing a Million Minds: Confronting the Tragedy of Alzheimer's and other Dementias: U.S. Congress Office of Technology Assessment” US Government Printing Office). Also see Alzheimer's Association at [www.alz.org](http://www.alz.org).
- (4) Assumes \$140,000 annual cost inflating at 4%.