Coping with the Rising Costs of Healthcare

May 13 2016

Longer lifespans and challenging healthcare costs are driving Americans to minimize their financial exposure to uncovered bouts of care—particularly in retirement.

The United States spends roughly $3 trillion annually on medical care, or just under $10,000 per capita—well above peers in the developed world. And while the pace of increase has slowed to the single digits, clocking in at 5.3% in 2014, it still outpaces that of inflation and wage growth.1

Systemic efforts to rein in costs have been met with some success. Increasingly consolidated hospital networks are better positioned to deliver treatment at scale and pass savings onto patients and insurers; state insurance marketplaces have brought millions under subsidized insurance umbrellas; and a new emphasis on preventative care is intended to address medical issues before they snowball into chronic and costly conditions.
But at the same time, one mark of the changing healthcare system—patients shouldering a larger share of treatment costs—is driving up out-of-pocket expenses across the board. The brunt often falls on the elderly, who require the most care.

Rising costs mean it’s incumbent on future retirees to take steps to minimize their financial exposure to uncovered bouts of care. But whereas the incentives for saving for retirement are easy to digest—to be able to afford a certain lifestyle after working years—planning for the less palatable aspects of old age are more challenging.

Planning for the Future

According to the American Association for Long-Term Care Insurance, more than two thirds of adults will require some form of long-term care after age 65.2 Another recent report found that one year of a private room in a nursing home care costs $91,250 today; in 20 years, that number is projected to reach $295,960.3 Even robust portfolios may be unfit to absorb costs of that magnitude, and yet many retirement-age Americans tend to avoid planning for those expenses.

The Centers for Medicare and Medicaid Services estimates that overall medical costs will rise about 5.8% annually through 2024, and longer lifespans mean a growing portion of the retired population will live longer with chronic conditions that require specialized care not covered by Medicare.

Faced with these daunting numbers, the question is how do you get ahead of unanticipated medical costs and mitigate their impact on your investments—and in the process preserve wealth to transfer to your heirs?

The Costs of Not Knowing

A 2015 survey by Nationwide Retirement Institute found that 79% of respondents have no clue what their healthcare costs will be or dramatically underestimate them, even though 63% report that their top fear about retirement is out-of-control healthcare costs.5

Those fears are warranted. Kevin McGarry, director of the Nationwide Retirement Institute, says the average retired couple now spends about $15,000 a year on healthcare, of which more than half goes to Medicare premiums, and they will spend somewhere between $240,000 and $420,000 over the course of their retirement, depending on their lifespan and health conditions.

Should they encounter serious medical trouble, the costs are even higher. “What's frightening is that people don't understand the uninsured costs they may face," says Aaron Edelman, a Morgan Stanley Private Wealth Advisor. “If someone gets a stroke and is unable to move the right side of their body, they're going to live a long time but will need 24-hour assistance.”
According to Edelman, Medicare Part A covers nursing care provided in a skilled nursing facility for a limited time, but only after a qualified hospitalization. However, Medicare will not pay for nursing homes when custodial care is the only care needed or care for conditions such as Alzheimer’s. Patients suffering from Alzheimer’s or other cognitive ailments may live for many years, all the while requiring assistance and, as the disease worsens, expensive hands-on care.

The projected cost of the average nursing home in the US in 2016 is $95k a year and higher end nursing homes can cost north of $180k a year. Even in-home custodial care will cost the average American $60k to $140k a year.6

**Protection for Retirement**

By the time people reach their 30s they tend to have a pretty good idea of the lifestyle they want to pursue, including in retirement, says McGarry. There are a number of ways to save for retirement with your future healthcare needs in mind.

Investors in their 30s or early 40s, he says, may weight their retirement-funding strategies toward a portfolio of mutual funds or a managed-account solution, to provide upside exposure to the market. Given lower premiums for younger policyholders, long-term-care (LTC) insurance should also be a consideration, he said.

Edelman also recommends LTC insurance to younger investors. However, these days only a handful of insurers offer LTC insurance, so another option may be life insurance with an LTC rider, which allows families to tap into the benefits they would receive upon the policyholder’s death while he or she is alive and requires care.

Another option for funding long term care expenses is to withdraw or borrow money from life policies or withdraw or annuitize annuities although this would probably not cover the cost of care should someone need care for another 15 or 20 years.

McGarry says younger investors seeking less risk may want to couple mutual fund portfolios with some annuity exposure, and those within 10 years of retirement may lean their portfolios toward variable annuities that offer market upside until retirement, and then guaranteed income.

**Paying for Unexpected Costs**

A final consideration is what to do when you’re faced with a large unexpected healthcare cost today. One answer may be a securities based loan, which may be available to qualified Morgan Stanley clients. When faced with a large healthcare expense, investors often liquidate financial assets to cover liabilities. However, this strategy may have costs which are not always obvious, such as tax consequences, potential loss of future growth or an imbalance in your portfolio’s asset allocation.
Once approved, a securities based loan may allow you to gain quick access to funds for a variety of needs while providing the opportunity may leave your portfolio intact and the strategy unchanged. Your Morgan Stanley Financial Advisor can provide you with additional information about the options available to you to help optimize your balance sheet and potentially cover large unexpected healthcare expenses.

**Protect Your Assets and Your Health**

As the costs of healthcare continue to rise, it’s important to understand all of the options available to protect the assets you’ve spent a lifetime accumulating. Your Morgan Stanley Financial Advisor has access to multiple long-term care products from a wide variety of respected insurers and can help you choose the one that offers the optimal combination of cost and benefits. Start the conversation.
Borrowing against securities may not be suitable for everyone. You should be aware that there are risks associated with a securities based loan, including possible margin calls on short notice, and that market conditions can magnify any potential for loss. For details please see the important disclosures below.


4 Source: Nationwide Retirement Institute, Pre-Retirees Fear Health Care Costs, But Are Not Taking Action, December 2015

Securities based loans are provided by Morgan Stanley Smith Barney LLC, Morgan Stanley Private Bank, National Association or Morgan Stanley Bank, N.A, as applicable.

Important Risk Information for Securities Based Lending: You need to understand that: (1) Sufficient collateral must be maintained to support your loan(s) and to take future advances; (2) You may have to deposit additional cash or eligible securities on short notice; (3) Some or all of your securities may be sold without prior notice in order to maintain account equity at required maintenance levels. You will not be entitled to choose the securities that will be sold. These actions may interrupt your long-term investment strategy and may result in adverse tax consequences or in additional fees being assessed; (4) Morgan Stanley Bank, N.A., Morgan Stanley Private Bank, National Association or Morgan Stanley Smith Barney LLC (collectively referred to as “Morgan Stanley”) reserves the right not to fund any advance request due to insufficient collateral or for any other reason except for any portion of a securities based loan that is identified as a committed facility; (5) Morgan Stanley reserves the right to increase your collateral maintenance requirements at any time without notice; and (6) Morgan Stanley reserves the right to call securities based loans at any time and for any reason.

With the exception of a margin loan, the proceeds from securities based loan products may not be used to purchase, trade, or carry margin stock (or securities, with respect to Express CreditLine); repay margin debt that was used to purchase, trade or carry margin stock (or securities, with respect to Express CreditLine); and cannot be deposited into a Morgan Stanley Smith Barney LLC or other brokerage account.

To be eligible for a securities based loan, a client must have a brokerage account at Morgan Stanley Smith Barney LLC that contains eligible securities, which shall serve as collateral for the securities based loan.

Morgan Stanley Smith Barney LLC is a registered Broker/Dealer, Member SIPC, and not a bank. Where appropriate, Morgan Stanley Smith Barney LLC has entered into arrangements with banks and other third parties to assist in offering certain banking related products and services.

Investment, insurance and annuity products offered through Morgan Stanley Smith Barney LLC are: NOT FDIC INSURED | MAY LOSE VALUE | NOT BANK GUARANTEED | NOT A BANK DEPOSIT | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

Insurance products are offered in conjunction with Morgan Stanley Smith Barney LLC’s licensed insurance agency affiliates.

© 2016 Morgan Stanley Smith Barney LLC. Member SIPC. All rights reserved.
CRC 1490725 (5/16)