

Medicare vs. Medicaid for Long-Term Care: What You Don't Know Can Cost You

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Uncover the critical differences between Medicare and Medicaid's roles in covering these costs, and learn why relying solely on Medicare could be a costly mistake.

By Michael W. Lynch

The fantastically prolific and always insightful Center for Retirement Research at Boston College (CRR) recently released [a study](#) focusing on the actual and perceived risks of paying for health-related expenses in retirement. Using survey research, CRR examined the differences in perceptions and knowledge of both Americans and their financial advisers.

What Can Go Wrong?

As a successful adviser who's spent more than two decades working with the vast American middle class, I know you face one real financial risk. It's the prospect of paying rent in the wrong kind of hotel for an extended period. (I developed this idea early in my career when it dawned on me that the daily cost of staying in a long-term care facility in which you had a roommate, an old TV and a shared bathroom cost more than a night at the Ritz Carlton, in many cases.) This is the only thing, in my experience, that wipes out middle-class wealth.

All good advisers know this. The questions to ask about your risk of needing long-term care include:

- How likely is the risk?
 - Can it be transferred for a reasonable price to a third party?
 - What do governments offer in terms of social insurance?
 - What other, non-insurance risk mitigation strategies can I use to preserve my wealth?
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I want to use the Center's study as a base to examine each of these questions and explore the potential opportunities that the answers offer you. This exercise may allow you to put a plan in place that best meets your needs. It's a complex topic so I break it into a two part series. I'll address the first three questions in this piece. I'll focus on the fourth in an article to follow.

Focus on the Consequences, Not the Probability

How likely is it that an American retiree will end up needing long-term care? How likely are you to face a financially catastrophic illness? The Center's study reports that 80% of Americans will need long-term care services. It reports that four in 10 of us will have high-intensity needs that last for more than a year.

This is consistent with other estimates you'll see in the personal finance press. If this is true, it means a married couple could expect at least one of their four parents to spend more than a year under intense custodial care.

I'm not convinced that this accurately represents the true probability. The Kaiser Family Foundation, a leading research and advocacy organization in this field, [reports](#) that that only six million Americans are currently receiving what it calls long-term services and support care. This is roughly 10% of the 58 million Medicare participants over age 65.

Something seems to be off here. And I think the something that is off is what's classified as long-term care. If you have a knee replaced and spend a week or two in a rehab facility, is that long-term care? Perhaps, and I believe it's counted in most numbers. But it's not financially catastrophic, and it is paid by Medicare. It would also not be a long enough stay to trigger traditional long-term care insurance policies.

The percentage of long-term care insurance contracts that actually pay would be an incredibly useful gauge of actual risk. I can't find a recent citation of this anywhere.

Ultimately, the probability may not really matter to you. The point is not merely the chance of a horrible thing happening, but what are the consequences to you and your loved ones if it does?

This brings up the second question. Can this risk be transferred to a third party for a reasonable price?

Those Were the Days

Imagine this: You plan to retire in a decade and project you'll have investments at roughly \$1 million, two Social Security payments totaling \$60,000 annually and a \$12,000 annual pension. You could easily pay your bills and manage most risks with asset allocation and

perhaps an annuity that could provide a lifetime of retirement income. You have three children; two are financially independent. Your youngest daughter has special needs and, although most of her needs are provided for by your state government, she relies on you for life's extras and her housing. As a result, dying broke terrifies you.

The insurance industry used to leap into the breach with terrific solutions. In some states, you could, at an affordable price, purchase a policy that not only paid the bills but also allowed you to keep a dollar of investments for every dollar the policy paid and still, eventually, have the state pick up the tab. These are called Partnership policies. They are still available in some states, but the cost places them out of middle-class reach.

This took care of the dreaded outlier cases of more than five years of expensive care. Your house is protected for your daughter due to her disability. Better yet, if you elected a return of premium rider and didn't use your policy, you didn't lose by winning. Every dollar you paid in was returned to your beneficiaries. Your heirs lost the gains that money would have made if invested, which was the true cost of the policy.

This used to be standard planning although it was often a struggle to get people to see the value in it.

We've Got New Policies

That, it turns out, was the peak product suite for long-term care protection. It's now long gone, killed by rock bottom interest rates among other actuarial considerations. If you have an old policy, hang onto it. But if you can work a financial calculator, you're not likely to sign a new application for standard long-term care insurance given today's prices.

The insurance industry has moved to hybrids. These policies are called hybrids because they add a long-term care rider to either a life insurance or an annuity contract. They are a useful innovation, and, in some cases, can play an important role in protecting your wealth. But there are trade offs: the benefit of knowing you'll get a life insurance payment regardless of when you pass away means less protection for the large monthly long-term care bill.

Clearing Up the Confusion

So if the bill isn't sent to a private insurer, who is likely to pay? This gets to the third question of what social insurance programs are available to provide support.

The study notes that 45% of Americans believe Medicare will pay for long-term care. However, Medicare doesn't pay for custodial long-term care services after, at most, a 100-

day stay.

Who's picking up the tab?

Medicare may pay for the first 100 days and 100% of rehabilitation but how many admissions that are classified as long-term care are completed in this period? I can't find data to answer this question.

The study also notes that only 6% of Americans believe Medicaid will pay. Yet Medicaid picks up 61% of the total tab. Medicaid is in fact the fallback long-term care financing plan for all Americans. We pay for it through taxes at the federal and state levels.

Some of the confusion is simply because of name similarities – Medicare and Medicaid sound similar and the general public may not understand the difference. Frequently, people who say “Medicare will pay” mean “Medicaid will pay,” which it actually does.

The problem is noted by the same authors in [another study](#). “Medicaid is a safety net, but not an effective form of insurance,” the authors write, “since its deductible is virtually all a household's assets.”

I will address ways to avoid this deductible in my next piece.

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