NAGDCA

FACTORING HEALTH CARE COSTS INTO YOUR RETIREMENT PLAN

The unfortunate state of Americans' financial preparedness for retirement is well-documented, and may be summed in two words: **NOT READY**.

Workers themselves know it. In fact, only 22% of workers are very confident they will have enough money in retirement, according to the Employee Benefit Research Institute's 25th annual *Retirement Confidence Survey*. Sixty-four percent (64%) say they know they are behind where they should be with their savings.[1] While the EBRI survey reveals workers' confidence in their retirement readiness, recent Congressional testimony documents the challenge in stark dollars and cents:

> *Nearly half (45%) of Americans have no retirement savings, and those least likely to own a retirement account are lower-income households. Although nearly 90% of households in the highest income quartile own retirement accounts, only about a quarter of households in the lowest income quartile have such accounts. Overall, the average working household has little to nothing saved for retirement. The median retirement-account balance is only $3,000 for working-age households and only $12,000 for households approaching retirement. In two-thirds of working households with earners between ages 55 and 64 years, at least one earner has saved less than one year's income for retirement. Such savings fall far below what they will need to maintain their present standard of living.*[2]

The reality is, Americans age 50 and above may become the first generation since the Great Depression to face retirement with greater financial challenges than those preceding them. Women may be even worse off. According to the Department of Labor,[3] women are more likely to work in part-time jobs that don't qualify for a retirement plan or interrupt their careers to take care of family members, resulting in lower retirement plan savings. In addition, women tend to live longer than men – a female at age 65 can expect to live another 20 years, 2 years longer than a man of the same age. An upper-middle-class couple age 65 today has a 43% chance that one or both will survive to at least age 95, according to the Society of Actuaries.[4]

1 *The 2015 Retirement Confidence Survey*, Employee Benefits Research Institute (April 2015)
2 *How prepared are Americans for retirement: Written testimony to the Special Committee on Aging*, Michal Grinstein-Weiss, Non-resident Senior Fellow, Brookings Institute (March 2015)
3 *Women And Retirement Savings*, Department of Labor (August 2013)
4 *RP-2014 Mortality Tables (Draft)*, Society of Actuaries (February 2014)

When it comes to defined contribution retirement programs, women are more diligent savers, are more likely to enroll when sign up is voluntary, and at all salary levels they tend to contribute a higher percentage of their income to their plans.[5] Yet at retirement, their balances tend to fall well short of their male counterparts. One of the reasons is women are less likely to take on risk to increase returns. Because they are likely to live longer, this cautious approach can leave them less financially prepared for retirement.[6]

While most of the preceding information is well known, the "hidden challenge" facing most workers after they retire is: Out-of-pocket health care costs in retirement may be greater than they may expect them to be.

HOW HEALTH CARE CONTRIBUTES TO THE RETIREMENT GAP

Health care is a big-ticket expense for most retirees, especially with rising costs and the potential likelihood of needing long-term care. Health care spending is projected to grow 5.8% each year through 2022.[7]

In the past, many American workers' employers picked up a share of their health care costs in retirement. However, soaring health care costs, Americans' increased longevity, and the sheer size of the Baby Boomer population as 1,000 turn age 65 each day are driving a major shift in employer-provided retiree health benefits. The fact is these plans are disappearing.

Only one-in-six large employers (considered 500 to 4,999 employees) offer health insurance coverage to retirees.[8]

This collision of soaring costs and shrinking employer coverage means that today, the average 65-year-old couple today can expect their out-of-pocket costs to reach $220,000 over 20 years in retirement.[9] With retirement plan balances more inadequate in size, health care costs threaten the financial welfare of many future retirees.

WON'T MEDICARE PAY FOR THESE COSTS?

Answer: It will, but only up to a point.

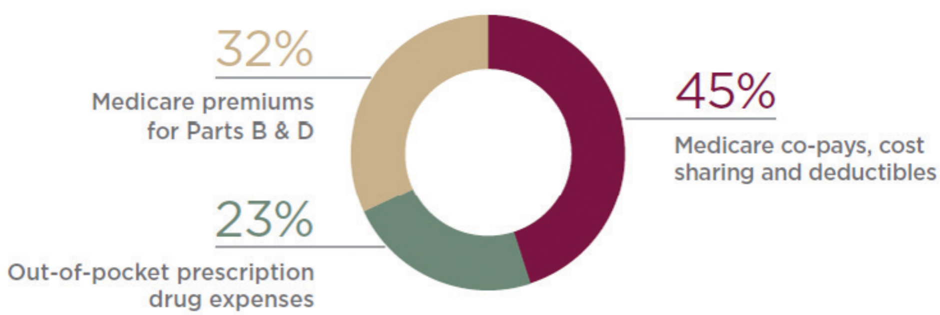
Medicare is the federal health insurance program for people who are 65 or older and certain younger people with disabilities. Americans are eligible for Medicare benefits in the month they turn age 65. Enrollees have several coverage options to consider when signing up, summarized in the chart below. The key words to look for may be found in the right column: premiums, co-pays, and deductibles. These costs are borne by the individual.

The Medicare program is facing the same pressures individuals and employers are facing: soaring health care costs, increased longevity, and a huge population becoming eligible for coverage. In 2014, more than 48 million Americans were covered by Medicare; by 2050, the enrollment is projected to be closer to 95 million.[10]

5 *How America Saves 2014*, Vanguard (June 2014)
6 *Global Investor Impulse Survey*, Black Rock (November 2013)
7 *National Health Expenditure Projections, 2012–22: Slow Growth Until Coverage Expands And Economy Improves*, Health Affairs (September 2013)
8 *National Survey of Employer-Sponsored Health Plans*, Mercer (2013)
9 *How to tame retiree health care costs*, Fidelity Investments (May 2013)
10 *Statistics and facts about Medicare*, www.statista.com/topics/1167/medicare/ (accessed May 11, 2015)

	What it's called	What's covered	What you pay for
Path 1	**Part A: Hospital insurance**	• Inpatient hospitalization • Skilled nursing facilities (with limitation and upon meeting qualifications) • Skilled home-based and hospice care (not long-term)	• No monthly premiums • Yearly deductible • Daily co-pays for first 150 days of treatment
Path 1	**Part B: Medical insurance**	• Doctor & physician services • Preventive benefits • Durable medical equipment • Outpatient services	• Monthly premiums • Yearly deductible • Co-insurance on physician services and outpatient care
Path 1	**Part D: Prescription drug coverage**	• Plans offered by private insurance companies approved by Medicare • Covered drugs vary by plan	• Monthly premiums • Yearly deductibles • Co-pays before and after the "coverage gap" • Discounted costs within the "coverage gap"
Path 2	**Part C: Medicare advantage**	• Offered by private insurance companies approved by Medicare • Includes Parts A & B • Most plans include Part D • May cover hearing, dental and vision treatment	• Monthly premium for Part B • Deductibles and co-pays will vary by plan

Congress reacted to the program's soaring budget-deficit projections by mandating in the Patient Protection and Affordable Care Act of 2010 various cost-containment measures. For the most part, the savings accrue to the federal government. Thus, the average retiree can expect Medicare to cover just 62% of their annual health care expenses.[11] The graphic below identifies where the dollars retirees spend on health care go.



11 *How Much Does Medicare Cover?* Employee Benefit Research Institute Fast Facts newsletter #251 (October 2013)

Having to cover 38% of their annual health care costs creates quite a gap in the average retiree's budget. To cover this gap, many retirees turn to supplemental insurance or choose to continue health insurance benefits from a former employer. This coverage is offered through private insurance plans, which can set their own rules and cost provisions for participants as outlined below.

Retiree health insurance coverage (Group health plans)	• Offered voluntarily by companies, who control coverage • Enrollees are responsible for paying premiums, co-pays, shared costs and deductibles • May include coverage for spouses • May not cover costs while you're eligible for but not yet enrolled in Medicare

Medigap plans	• Must be enrolled in Medicare A & B to qualify • Spouses must have separate policies • Monthly premium paid to the insurance provider in addition to monthly Medicare Part B premium • Prescription drugs not covered (coverage available through Medicare Part D)

So, what do these costs look like in dollars and cents? In the table below, we assume a modified adjusted gross income in retirement of less than $170,000 and that the individual is healthy and has no additional health care expenses besides Medicare premiums.

	Monthly	Annual
Medicare Part A	$0	$0
Medicare Part B	$104.90[7]	$1,258.80
Medicare Part D	$37.20	$446.40[8]
Medigap Plan (supplemental)	$186.00	$2,232.00[9]
Total per person	**$328.10**	**$3,937.20**
Per couple	**$656.20**	**$7,874.40**

[12]

12 *Medicare 2014 & 2015 costs at a glance*. www.medicare.gov/your-medicare-costs/costs-at-a-glance/costs-at-glance.html; *Medicare Part D: A First Look at Plan Offerings in 2015*, weighted average premium for Medicare Part D Stand-Alone Prescription Drug Plans, Kaiser Family Foundation (October 2013); Medigap Insurance can vary by carrier and state. Medicare.gov. Median cost for a Medigap Policy C in Columbus, Ohio. Premiums range from $119 to $253. Accessed November 1, 2014. (Listed as footnotes 7, 8, 9 in the table.)

None of these premium costs include any event that triggers coverage; that is, the deductibles and co-pays would be in addition to these costs. But clearly, just enrolling in Medicare and supplemental insurance coverage will have an impact on an individual's financial plan for retirement.

Choosing the right Medicare option and planning for out-of-pocket expenses is just one part of the retirement health care equation. Another concern is long-term care: 7 out of 10 individuals over age 65 will need long-term care at some point.[13]

WHAT IS LONG-TERM CARE?

Many Americans think of long-term care (LTC) as nursing home care, yet that is a fraction of the possible challenges covered under this broad heading. Assisted living and total (nursing home) care accounts for significant services in the United States, with costs potentially exceeding $200,000. But most LTC happens in the home, with loved ones "voluntarily" absorbing the expenses gratis. While likely to be less than for assisted living and total care, the costs for those providing in-home care can be substantial.[14]

Home health care	Adult day care*	Assisted living	Nursing home (Semi-private room)	Nursing home (Private room)
$98,280	$81,900	$191,700	$202,575	$226,300

[15]

Statistically speaking, women are the more fortunate sex, as they tend to live longer lives. But, as the graphic below suggests, those extra years can be a struggle for women who are widowed — especially after losing a spouse following a period of long-term care. Not only are women more likely to be caregivers, they are also more likely to be on their own when they may need care themselves. That is why it is important for couples to establish a long-term care plan, including how to pay for it.

13 *Long-term care: Who needs care?*, U.S. Department of Health and Human Services, http://longtermcare.gov/the-basics/who-needs-care/ (accessed October 7, 2014)
14 *Long-term care: Costs of care*, U.S. Department of Health and Human Services, http://longtermcare.gov/costs-how-to-pay/costs-of-care/ (accessed June 22, 2015)
15 *Market Survey of Long-Term Care Costs*. MetLife Mature Market Institute (November 2012)

[16]

Medicare doesn't cover for LTC costs as they are generally considered excluded from its coverage. While state-run Medicaid programs cover long-term care expenses for some people, Medicaid is meant to assist impoverished individuals with medical expenses. In order to meet the Medicaid requirements to pay LTC costs, an individual cannot have more than $2,000 in qualified assets, and annual income has to be near or below federal poverty guidelines. Trying to qualify for Medicaid coverage for long-term care expenses would require difficult choices that can have an adverse financial impact on an individual and their family.

A more realistic solution is to consider long-term care costs in an overall financial plan, well ahead of retirement. Planning ahead for the likelihood of needing long-term care can make the difference between financial security and devastation.

CREATING A HEALTH AND LONG-TERM PLAN

As discussed, health and long-term care comprise a potentially significant gap in many Americans' retirement planning. To help fill the gap, many employers are taking a cue from financial planners: offering programs and resources to help workers recognize the challenges they face and plan for them.

Among those resources may be a health care cost assessment, a tool designed to help individuals estimate expected costs and identify ways to cover them. Many of these tools are interactive, allowing individuals to input information .Some are sophisticated enough to incorporate not only what the employer knows about their workers' situation, but also what they can cull from outside resources such as Social Security and Medicare. Most offer observations and recommendations, based on the information that has been assembled, that can help workers refine their retirement planning. A few may even suggest funding options or investment portfolio adjustments to help workers achieve their goals. Of course, the more information the tool has, the more reliable its observations and recommendations can be.

THE ROLE OF THE DEFERRED COMPENSATION PLAN

More and more employers are recognizing that their supplemental retirement plan can serve as an excellent funding mechanism for the retirement gap caused by unanticipated health and long-term care needs. In the public sector, governmental 457(b) deferred compensation plans are very well suited to this need.

[16] *The 2011 Sourcebook for Long-term Care Insurance Information*, (AALTCI 2011); Understanding the Impact of Family Caregiving on Work, AARP Public Policy Institute (October 2012) (Listed as footnotes 13 and 14 in the graphic.)

First off, workers usually have a pension for their retirement income needs, but generally do not consider how health and long-term care costs can overwhelm their retirement budget. Employers can position their deferred compensation plan as a tax-deferred savings program to help prepare for these costs. For those who employ public safety workers, the law allows direct, non-taxed payment of retiree health insurance premiums and certain eligible expenses from a governmental 457(b) account for up to $3,000 per year.

Secondly, the employer/plan sponsor can encourage their 457(b) plan provider to tailor educational workshops, newsletters, and guidance around this topic.

Thirdly, the plan provider may be able to offer health care cost and Social Security assessments, in addition to an interactive retirement planner and other online tools for the plan website. The availability of these resources can help public employees see that their defined benefit pension is not designed to cover the budget gaps health and long-term care costs create, and identify solutions through the employer's deferred compensation plan.

SUMMARY

Studies and surveys have repeatedly shown that Americans are not adequately prepared for retirement. Even in the public sector where defined benefit pension and retiree health insurance programs are more prevalent, workers face potentially significant coverage gaps they may not be aware of. The benefits and HR teams of governmental employers can be instrumental in alerting workers to these gaps. Employers may be able to turn to their supplemental retirement plan provider for assistance. Many offer education, ongoing communications, workshops and other media to drive workers to resources available through the plan that can help them identify individual financial needs and save for them.