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Retirement Healthcare Continuum

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You may have heard us refer to a concept called the Wealth Management Continuum which focuses on key financial planning issues along an investor's lifecycle. Using the same imagery, I want to touch on some of the key considerations for retirees as it relates to healthcare costs in retirement. Think of this continuum in 3 stages: Pre-Medicare, Medicare and Long Term Care. There is no debating the fact that funding healthcare expenses will be a key component to any successful retirement plan. According to Fidelity Benefits Consulting, a 65 year old couple retiring in 2014 will need on average $220,000 to cover medical expenses throughout retirement[1]. This figure does not include potential long-term care expenses.

Pre-Medicare

The average retirement age continues to be on the rise given longer life expectancies and the increasing responsibility on individuals to fund their own retirement as 401(k)'s replace pension plans. However, the average retirement age in 2014 of 62[2] remains several years shy of Medicare eligibility. Most individuals are confronted with a confusing set of alternatives during these "gap" years. There are very few employers that still provide retiree healthcare coverage leaving the focus on the individual health insurance marketplace. Navigating these waters has become more complex since the Affordable Care Act (ACA) was enacted into law. Private exchanges, public exchanges, tax subsidies, guaranteed insurability and penalties for non-compliance are all part of the new reality created by the ACA.

There are several planning implications during this healthcare stage. First, it's important to secure coverage that is consistent with how you envision using health insurance. If you are healthy and comfortable retaining some of the risk, a high deductible plan might be a good solution. Alternatively, you may have some chronic health needs that would justify lower deductibles and higher monthly costs. Either way, you will most likely encounter higher costs compared to the plan offered by your previous employer, so it is important to have that reflected in your retirement budget. In some cases, a tax subsidy may be a possibility. For 2015, a married couple with household income of **less than** $62,920 would qualify for a tax credit[3]. Income is defined as Modified Adjusted Gross Income (MAGI) and there are certain things that can be done to reduce your income for the purpose of qualifying for a tax subsidy under the ACA. Regardless of circumstance, it's clear that the Pre-Medicare stage of the healthcare continuum has several moving parts and can become quite costly without the optimal plan in place.

Medicare

July 30, 2015 marks the 50th anniversary of the establishment of Medicare by Lyndon Johnson in 1965. Medicare eligibility begins when someone turns 65 but can be delayed if you are still employed and have credible coverage. This is an important stage of the healthcare continuum. For a lot of people it will mean reduced costs and better coverage than they were receiving on an individual plan. The key with Medicare is understanding the numerous options and important enrollment dates. Medicare consists of Part A (Hospital Insurance), Part B (Medical Insurance), Part D (Prescription Drug Coverage) as well as Medicare Advantage Plans and Medigap Supplemental Insurance. Part A is free if you or your spouse paid Medicare taxes while working. Part B requires a monthly premium based on your income level two years prior to the coverage year. Many retirees begin paying a fairly high Part B premium based on their work related income leading up to retirement. In some cases, you can fight for a reduction in your Part B premium based on certain qualifying

events. A married couple earning $170,000 or less will pay the lowest Part B premium[4].

Part D enrollment typically requires the most due diligence. While the average premium for Part D coverage in 2015 is $38.83 per month[5], costs can escalate based on coinsurance, formularies and the coverage gap (referred to as the "donut hole"). It is important to understand how your medications will be covered on a plan's formulary. There are several tools available on the internet or through an insurance agent to determine out of pocket costs based on current prescriptions. I would highly recommend that level of discovery before selecting a provider. In addition, take advantage of the open enrollment period each year (October 15 – December 7) to shop around for a more cost effective plan. On the subject of enrollment periods, a few key dates to remember. The Initial Enrollment Period for Medicare begins 3 months prior to your 65th birthday and ends 3 months after your birthday. If you are still working or covered by a spouse's plan you may delay your enrollment without a Part B penalty. If you fail to enroll during the Initial Enrollment Period and don't maintain credible coverage you can enroll during the General Enrollment Period from (January 1 – March 31). However, you may be assessed a late penalty on your Part B premium.

Another important consideration involving Medicare is the selection of a Medigap policy or enrolling in a Medicare Advantage Plan. First, a quick primer on both. Medicare Advantage Plans are offered by private insurance companies and replace Parts A & B of original Medicare. Most Medicare Advantage Plans come with prescription drug coverage as well. Essentially, Medicare Advantage Plans replace Medicare and can have limitations with regard to using healthcare providers outside of a certain network. These plans work in a similar fashion to traditional HMOs and PPOs. Medicare Advantage Plans typically cost less than traditional Medicare but the reduction in cost has to be weighed against provider flexibility.

Medigap policies compliment Medicare Part A & B and as the name signifies they fill in any "gaps" in coverage. There are 10 standardized plans ranging from A to N. All insurance companies selling Medigap policies must offer the same benefits by law. Therefore, when shopping for a certain Medigap policy from two different providers it is best to go with the cheaper option since benefits are standardized. The majority of participants are enrolled in Plan C or Plan F which provide first dollar coverage for the entire plan year.

As you can see, there are a number of things to consider as you approach Medicare eligibility. Many of which have real planning considerations. It's important to understand the costs associated with each option both while you are healthy and in the event of a chronic health issue. Also, it's crucial to understand how the enrollment process works to avoid costly penalties and potentially a reduction in options. We would expect the Medicare landscape to evolve over time and continue to present opportunities to reassess your coverage.

Long Term Care

The last phase in this healthcare continuum involves planning for the possibility that you may require assistance with what are referred to as the "activities of daily living." The impact to one's financial plan can be significant and the probability of needing care increases with age. Here are some quick facts:

- 70% of people over the age of 65 will require some form of long term care services and support during their lives[6]
- 51% of new long term care claims are for in-home care[7]
- $45,760/year is the national average for in-home care[8]
- $91,250/year is the national average for nursing home care[8]
- Average length of stay in a nursing home is 3 years[9]

Given the high probability of needing support and the increasing costs of care, it is crucial to incorporate the impact of long term care into a well-developed retirement plan. One of the key considerations is whether or not one should purchase long term care insurance or plan to self-fund for any future expenses. First, let's address the evolution of long term care insurance.

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The industry has undergone a lot of changes since these policies were first introduced in the late 1970s and caught steam in the late 80s. Initially, it was a very profitable endeavor for insurance companies, as benefits were limited and people weren't living long enough to fully utilize the coverage they purchased. This invited competition and new entrants to the marketplace. As a result, insurance companies began offering richer benefits including in-home care and higher inflation adjustments. The result was large underwriting losses for many carriers as longevity rates increased and costs escalated. In addition, lapse rates for long term care insurance have historically been around 1% or less. This is significantly lower than life and disability insurance. Consequently, many carriers have gotten out of the long term care business or have passed along significant premium increases to their policyholders. Insurance 101 tells us to transfer risk when loss potential is high and the probability of a claim is low. Think of life and homeowner's insurance as ideal risks to insure. With long term care, loss potential is high but so is the probability of a claim. Given that backdrop, it is essential to explore the viability of self-funding prior to purchasing long term care insurance.

The viability of self-funding cannot be accurately assessed in the absence of a comprehensive retirement plan. There are a number of factors that are interrelated: outstanding debt, withdrawal rates relative to investable assets, family longevity, estate intentions, guaranteed income sources, investment risk tolerance, etc. This planning process will lead to more informed decisions related to funding long term care expenses. Often we find the best solution is a combination of self-funding coupled with a base amount of insurance. The amount and form of insurance is difficult to assess without the backdrop of a retirement plan. Daily benefit level, elimination period, inflation factor, pooled vs individual; are all factors that influence premiums and can be tailored to one's specific circumstances.

The common thread throughout the Healthcare Continuum is the presence of a comprehensive plan which is utilized as a tool to optimize outcomes. We are quite certain that the healthcare landscape will continue to evolve and those that have a plan in place will be best prepared to make adjustments along the way.

[1]Fidelity Benefits Consulting, 2014

[2]Gallup 2014

[3]Healthcare.gov

[4]Medicare.gov

[5]Kasier Family Foundation

[6]2015 *Medicare & You,* National Medicare Handbook, Centers for Medicare & Medicaid Services, September 2014

[7]JP Morgan Guide to Retirement, 2015

[8]Genworth Cost of Care Survey, 2015

[9]AARP Guide to Long Term Care

IMPORTANT DISCLOSURES:

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