



SAVING FOR HEALTH EXPENSES

Insurance premiums and out-of-pocket costs for services not covered by Medicare drive up projected retirement expenses and underscore the urgency for greater savings.

Researchers who study ways to increase both the commitment to savings and the savings rate tend to agree that having a specific savings goal is essential to success. The goal that Paul Fronstin, Dallas Salisbury, and Jack VanDerhei of the Employee Benefit Research Institute (EBRI) spotlight in “Funding Savings Needed for Health Expenses For Persons Eligible for Medicare” is the money people will need to save to pay for health expenses in retirement — a topic that should resonate with people in their 50s and early 60s.

The good news is that, thanks to Medicare, more seniors have health insurance than any other age group in the United States. Further, the most recent government statistics report that Medicare covered 64% of the healthcare costs of the program’s beneficiaries who were 65 and older. Of the balance, beneficiaries paid 14% out-of-pocket, and private insurance covered 11%. (The remaining 11% was funded primarily from other public sources including Medicaid and Veterans Affairs.)

The question is whether the 90% of beneficiaries with Medigap or employer plan insurance will have enough money to pay these premiums, Medicare Part D premiums and out-of-pocket healthcare costs throughout retirement. Those are on top of the premiums for Medicare Part B, which may also be a cost factor if there are large premium increases on a par with the 17% jump in 2004 and the 14.6% jump in 2010.

→ A QUICK LOOK

- Medicare covers about 64% of retiree healthcare costs.
- Balance covered with Medigap, Part D, and out-of-pocket payments.
- Savings required by age 65 for premiums and cash expenses may exceed \$200,000.
- The Patient Protection and Affordable Care Act of 2010 projected to reduce these costs up to 50% for some people by 2020.

UNCERTAIN NEEDS

One of the complicating factors in setting a savings goal to cover healthcare expenses in retirement is that it’s difficult to determine the actual amount people will need. As the authors of the study note, one can set a savings goal, but it “will be wrong for the vast majority of the population.” (Their solution is to provide a range of target savings.)

For example, it’s difficult to predict the cost of the care itself, as growth in Medicare spending since 1975 has outpaced economic growth by 2.5%. It’s similarly difficult to predict either a person’s need for prescription drugs or what those drugs will cost. Potential changes in the interest rate, and therefore the rate of return on savings, is also unknown.

But the greatest uncertainties of all are how long people will live — and therefore how long their savings will have to last — and how good or bad their health will be.

Another conundrum is that the cost of supplemental insurance varies widely based on the state where a person lives after retirement and in some cases, where within that state.

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VOL 2 NUMBER 1 JANUARY 2011

Using Plan F Medigap as a standard, the researchers found a \$13,656 disparity between the least expensive annual premium (\$948 in Oregon) and the most expensive (\$14,604 in Ohio). This disparity exists despite the fact that the law requires the coverage itself to be identical. The average cost for Plan F Medigap, in 2010, was \$1,479.

Amidst this uncertainty, however, two things are clear. First, women, on average, will need more savings than men, in large part because of their increased longevity. (Other studies also note that women, on average, also have greater healthcare needs, in part but not exclusively because of the number of annual diagnostic tests.) And second, a couple needs to save somewhat less, on average, than each partner would have to save separately and combined.

ARRIVING AT ESTIMATES

Despite what's unknowable, people do need a sense of how much they need to put aside to cover basic healthcare costs after age 65—over and above their basic retirement savings. Fronstin, Salisbury, and VanDerhei have calculated a range of amounts using statistical modeling to estimate needs for Medicare beneficiaries who have Medigap Plan F plus Medicare Part D or health insurance through their former employer.

Specifically, they computed the present value of the savings for a couple that retires at 65, taking two sets of variables into account. One variable is the degree of certainty savers could reasonably expect in being able to cover their costs. The second is the impact of increased prescription drug needs.

Assuming median drug expenses, Fronstin and his colleagues arrived at a savings target of \$158,000 for a couple who wants a 50-50 likelihood of being able to cover their future healthcare costs from savings.

That number rises to \$218,000 for a 75% likelihood, and to \$271,000 for a 90% likelihood. At the median drug expense level and a 90% certainty level, the savings target for a man would be \$124,000 and for a woman, \$152,000.

Unsurprisingly, as the projected need for prescription drugs increased, the savings target increased as well. To give one example, a woman whose need for prescription drug put her in the 90th percentile of prescription users would need to save \$213,000 to have a 90% chance of covering her premiums and out-of-pocket costs. Note that long-term care premiums and out-of-pocket costs were not included in this study.

A BRIGHT SPOT

The study does have some good news: The Patient Protection and Affordable Care Act of 2010 (PPACA) is projected, by 2020, to reduce from 100% to 25% the out-of-pocket cost of prescription drugs for Medicare Part D beneficiaries who hit the infamous “doughnut hole,” and are responsible for 100% their bills until they reach the next spending plateau. This change in turn reduces the projected savings need for someone with median drug costs by 25% to 30% if they want to save enough to ensure a 50-50 likelihood of covering their costs and by 40% to 50% for someone with high drug costs who wants a 90% likelihood of being able to cover costs.

In providing their estimates, the authors caution not only that healthcare savings are separate from regular retirement savings but that 65 is too late to start thinking about accumulating what's needed. They also caution that their estimates don't take into account the effect of retiring (whether willingly or not) before 65. Nor do they know what changes may be in store in the Medicare program that would affect beneficiary costs.

Paul Fronstin, Jack VanDerhei, and Dallas Salisbury, “Funding Savings Needed for Health Expenses For Persons Eligible for Medicare,” EBRI Issue Brief, no. 351, December 2010.