How to tame retiree health care costs

Why planning is critical and may help lower costs.

Most of us look forward to retirement as a time to shift gears, worry less, and enjoy a slower pace of life. But that rosy picture can quickly change and include some sticker shock as retirement nears, especially when it comes to paying for health care.

A couple retiring in 2013 is expected to need $220,000 to cover health care cost in retirement, down 8% from last year’s estimate of $240,000.1

"While lower, this year’s estimate is still daunting for many retirees, and it will consume a considerable amount of a couple’s retirement savings," said Brad Kimler, executive vice president of Fidelity’s Benefits Consulting business. "It is extremely important that health care costs are factored into retirement savings strategies today so that retirees can be prepared to pay their medical bills throughout retirement."

As the chart below shows, retirees now spend more on health care than they do on food. If that trend continues, health care will be retirees’ second-largest expense in just a few years, says Steven Feinschreiber, senior vice president of research and development at Strategic Advisers, Inc., a registered investment adviser and Fidelity Investments company.2

As life expectancies increase and people spend more years in retirement, the money set aside to pay for health care will have to last longer as well. Clearly, factoring in health care expenses has become a critical part of retirement planning. Fortunately, there are steps you can take to ease your mind—and your budget—so you arrive at retirement with potentially fewer worries about managing your health care costs.

1. Understand your health insurance options

To take control of your health care expenditures, "You need to educate yourself in terms of what your options for health expense coverage are: what you need, where you can get it, and the cost for that coverage," says Sunit Patel, senior vice president of Fidelity Benefits Consulting. That education starts with understanding what your options for health insurance will be once you retire.

For most retirees, leaving full-time employment will mean leaving employer-provided health care coverage behind. Today, only 28% of firms with 200 or more employees (and just 3% of small firms) still offer retirement health care coverage.3 Even then, the plan may differ dramatically from its preretirement version. There may be different deductibles, co-pays, or other limitations, and you may be sharing a larger amount, if not all, of the cost of the premium.

Medicare covers most retirees

While some people may have access to employer-provided retiree health care coverage, the government’s Medicare health insurance program is still the primary source of health coverage for American retirees. Most automatically qualify for basic Medicare hospital insurance (known as Part A) as soon as they reach age 65. This coverage costs nothing if you or your spouse paid Medicare taxes during your working years.

On the other hand, Medicare medical insurance (known as Part B), which covers doctors’ services, outpatient hospital care, and some other medical services such as physical and occupational therapy and some home
health care, is not free. You pay a monthly premium for Part B, and there’s no annual limit on your out-of-pocket expenses as there is with many private insurance policies.

Medicare Advantage plans combine Medicare Parts A and B and supplemental coverage in a single policy. They are privately managed and can offer lower premiums or better benefits than a traditional Medicare setup where each part is treated separately. But these plans also can limit you to using only network providers.

Prescription drug costs have also gone up; although it is only 10% of total health expenditures, spending on prescription drugs has risen 114% from 2000 to 2010. To cover prescription drugs in retirement, you also can purchase Medicare Part D prescription coverage to add to Part A, Part B, and your Medigap coverage, or as part of a Medicare Advantage plan.

Choose the type of Medicare coverage that is best for you

Follow these steps to help you decide:

Although it can be time consuming to select coverage aimed at supplementing basic Medicare from the many private insurance options available in your state, it's an exercise that can make a big difference in your costs.

The government's Medicare site offers access to tools that help you compare coverage in your state and find insurers that offer the best value for your needs. Go to www.medicare.gov and select “Find Health and Drug Plans.” And don’t forget to ask prospective insurers if they have options to help you keep costs down, like higher deductibles, discounts for healthy lifestyles, or using only in-network providers.

What if you retire early?

If you retire before age 65, of course, you can’t take advantage of Medicare right away. So if you don’t have other coverage in the interim, you will need to find a source to pay for your medical insurance while you await eligibility for Medicare. In that case, you have a number of choices. Among them:

- Paying to continue your current employer coverage for a specified time under COBRA
- Joining your spouse’s company health care plan
- Purchasing your own medical insurance policy
- Using Veteran's Administration benefits, if you are a veteran
- Using Medicaid, if you qualify

As with any important financial purchase, think about the costs and coverage of your policy before you buy it, and look at the premiums you can afford, the deductibles, the available hospitals and doctors, the plan’s quality ranking information, the covered benefits, and the out-of-pocket expenses you will pay. Higher deductibles generally lower your costs but require you to pay more up front before your coverage kicks in.

2. Factor health care costs into your income planning
Once you have a better handle on the cost of the insurance coverage you'll need, you can begin looking at your health care costs along with your other essential retirement expenses. "On the financial side, you want to look closely at your anticipated medical costs as part of your larger income planning goal, because they are such an important and essential expense in retirement," says Patel.

Some online retirement planning tools, like Fidelity's Retirement Income Planner\(^6\) can help you create a ballpark estimate of how much of your budget for essential expenses should be allocated to medical and health care costs.

You also can use Fidelity's annual Retiree Health Care Costs Estimate as a basis for planning. This estimate suggests that a 65-year-old couple retiring in 2013 would need $220,000 in total to pay for medical expenses throughout their retirement (17 years for men, 20 years for women, on average), not including nursing home or long-term care.

That figure is an average cost, to be used as a general guideline, because it applies only to a 65-year-old couple retiring in 2013, says Patel. "If you're younger, this is not the right number for you." To arrive at a figure that better reflects your personal situation, he suggests adjusting the number to take into account your family history and your health status, which might mean planning for a longer or shorter retirement and a larger or smaller total cost. For example, if a husband and wife live to be 92 and 94, respectively, the cost estimate from Fidelity grows to $355,000.\(^8\)

You might want to earmark a portion of your budget for purchasing long term care insurance as well.\(^7\) The cost is based on age, so the earlier you purchase a policy, the lower the annual premiums.

Whatever method you use to estimate your health care expenses, including them in your overall income planning helps you invest that amount appropriately so you can cover health care costs without having to sell or liquidate investments unnecessarily.

3. Take advantage of all possible funding sources

In addition to any employer-sponsored benefits and your retirement accounts and personal savings, you may have other sources to help meet health care costs in retirement.

For example, if you have a health savings account (HSA) that is used in conjunction with a high-deductible health plan (HDHP), you can make pretax contributions to be used to pay qualified medical expenses. Earnings and withdrawals are also federal tax free if used to pay for qualified medical expenses.\(^6\) You can also use the funds in an HSA to pay for both current and future qualified medical expenses. Because you don't have to use the money right away, it can be set aside to cover future qualified medical expenses, including in retirement—and you'll be able to withdraw it free of income taxes in the future.

"Health savings accounts are a smart way to set aside funds specifically for medical needs," says Feinschreiber. "HSAs are not subject to the ‘use it or lose it’ rule and are completely portable for individuals who change employers."

Other sources of funds that might be available to cover your health care expenses include:

- Voluntary employees' beneficiary association (VEBA) plans. These are tax-favored trusts set up to provide health benefits to employees of school districts, higher education, and state agencies, and—more recently—union members. (The United Auto Workers [UAW] VEBA is the largest in the world.)
- Part-time work. Keeping health insurance benefits is one of the leading reasons retirees continue to work, according to the 2012 EBRI Retirement Confidence Survey.\(^9\)

4. Be a smart health care consumer

"Being informed and proactive about choosing your health care providers and managing your care may be the most effective ways to control health care costs in retirement," says Feinschreiber.

"If you identify the best providers for safe and cost-effective solutions before care is needed, you can save a significant amount of time and money later on," he explains. Feinschreiber suggests identifying in advance four types of providers to turn to in different situations: 1) a primary care physician, 2) a specialist for any existing conditions or special needs, 3) an urgent care provider, and 4) a full-service hospital. That way, you'll know where to go for the care that offers you the most value.

Other ways to make sure you get the most from your health care dollars:

- **Be prepared.** Be ready to give your provider the information that he or she needs—even to the point of writing down your questions or symptoms in advance of each visit. In addition to ensuring that your concerns are addressed efficiently (and you don't forget something important), this also makes the best use of everyone's time. Because physicians and facilities typically charge based on the time and complexity of a visit, this is even more important if you have a high-deductible health plan where you shoulder more of the up-front costs.

- **Ask the hard questions.** Make sure you get a clear description of any diagnosis and the doctor's proposed plan of care, free of confusing jargon. Ask about the benefits and risks of any procedures, and know what outcomes you can expect. See if any alternative treatments are available, and compare the cost and outcomes of those choices too.

- **Know what you're paying for.** What are the charges, fees, and out-of-pocket costs you should expect for the recommended treatment plan? Are there any factors you should know about that could cause the anticipated expenses to increase? Remember, along with your patient privacy rights, you also have the right to know as much as you can about the medical services being recommended, and their costs.

Being a good health care "shopper" may also help you lower your out-of-pocket costs for prescription drugs. Even with improved Part D insurance plans, prescriptions can cost thousands of dollars a year if you're treating a chronic condition. So check with your doctor or pharmacist to see if there are safe, efficient, and lower-cost alternatives to any brand name drugs you're using.

Also, Feinschreiber says that health care costs vary widely by geographical region, and suggests that people who are thinking about living in a different state during retirement should take these differences into account. To learn more about the state and regional cost comparisons, check the reports online at the Centers for Medicare & Medicaid Services.\(^10\)

Finally, "Don't underestimate the link between your health and your financial wealth," says Patel. "It's important to know what you
Planning for health care expenses in retirement has never been more important. By carefully considering your needs, expenses, and financial resources ahead of time, you will likely be in a better position to handle the costs when retirement finally arrives.

Learn more

- **Fidelity Retirement Income Planner** can help you determine how much of your budget in retirement should be allocated to medical and health care expenses.
- To learn more about Medicare health insurance coverage and supplemental coverage in your state, go to Medicare.gov.

1. The Fidelity Retiree Health Care Costs Estimate assumes individuals do not have employer-provided retiree health care coverage, but do qualify for the federal government’s insurance program, Medicare. The calculation takes into account cost-sharing provisions (such as deductibles and coinsurance) associated with Medicare Part A and Part B (inpatient and outpatient medical insurance). It also considers Medicare Part D (prescription drug coverage) premiums and out-of-pocket costs, as well as certain services excluded by Medicare. The estimate does not include other health-related expenses, such as over-the-counter medications, most dental services and long-term care. The estimate assumes no employer-provided retiree health care coverage, and life expectancies of 17 years for men and 20 years for women.


3. Only 28% of large firms with 200 or more workers offered retiree health insurance in 2010, down from 66% in 1988, according to a Kaiser Family Foundation survey of employers. And just 3% of small firms with from 3 to 199 workers have health plans for retirees.


5. Retirement Income Planner is an educational tool. The tool’s illustrations result from running a minimum of 250 hypothetical market simulations. The market return data used to generate the illustrations is intended to provide you with a general idea of how asset mixes have performed historically. Our analysis assumes a level of diversity within each asset class consistent with a market index benchmark, which may differ from the diversity of your own portfolio. Please note that the projections do not reflect the impact of any transaction costs or management and servicing fees (except variable annuities); if these had been included, the projected account balances would have been lower.

   **IMPORTANT:** The projections or other information generated by Fidelity’s Retirement Income Planner tool regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Results may vary with each use and over time.

6. See note 2, above.

7. LongTermCare.gov, How Much Care Will You Need?

8. With respect to federal taxation. State taxation may vary from state to state.


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