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Planning for Healthcare Expenses During Retirement -- An Advisor's Problem?

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The debate on the budget deficit has been pretty intense for the past couple of years. The main issue surrounding this debate has been healthcare, and rightfully so. According to the White House Budget Office, for the fiscal year 2012, the federal government collected about $2.5 trillion in revenue and spent over $900 billion on healthcare, which is more than a third of all tax receipts. The Medicare program (a health insurance program for people 65 or older, people under 65 with certain disabilities, and people with End-Stage Renal Disease) alone cost $545 billion, while Medicaid (a joint federal and state government healthcare program for people with limited means) cost about $250 billion. Despite this massive healthcare spending by the government, seniors continue to incur hundreds of thousand of dollars in out of pocket healthcare expenses during retirement. With the rising cost of healthcare and people living longer, the healthcare issue is not likely to disappear for the foreseeable future.

Consumer Awareness

Many people think that once they retire they need not worry about healthcare. They think that Medicare is free and it will take care of all their healthcare needs. That's just not true. Those who have cared for an ailing parent or a grandparent know all too well what financial and lifestyle implications healthcare may have for an individual as well as her loved ones. Consumer awareness is definitely lacking in this area. Many seniors also believe that once you enroll in the Medicare program, you are all set for life. They need to know that every year they have an opportunity to change different Medicare options and they should take advantage of this process to decide on different healthcare options based on their changing needs. It may not only be cost effective but also may help them get better services. Additionally, some people may think that they can part with a good chunk of their assets so as to qualify for Medicaid. However, it is important to note that the rules for Medicaid eligibility are becoming more

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and more stringent. In fact, Medicaid requires a five year look-back on the ownership of assets.

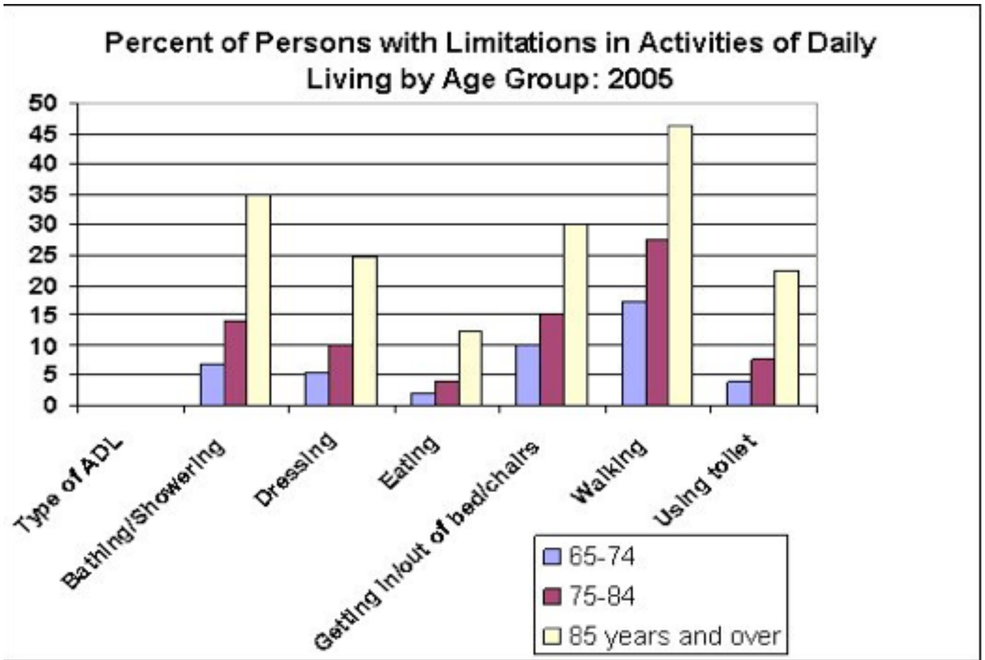
Financial Planning

Financial advisors haven't been on top of healthcare expenses to better prepare their clients for retirement. Most advisors agree that in order to develop a reasonable retirement income plan and to protect a client's estate planning goals, healthcare expenses need to be accounted for. But some advisors feel that there are "many unknowns" when it comes to healthcare expense planning. In a way financial planning is all about planning for unknowns: market rate of return is unknown, life expectancy of a client is unknown, and so is the rate of inflation to some extent. Yet, we create financial plans to manage these unknowns. Healthcare expense planning is no different. Consider this: a recent survey conducted by Harris Interactive for Nationwide Financial revealed that nearly half of high-net-worth Americans who are close to retirement are “terrified” of what health care costs may do to their retirement plans. But 38% of those surveyed said that they haven't discussed retirement health care costs with a financial adviser, in part because they are unsure as to whether their adviser is knowledgeable about the issue. This is not a good sign. Part of the reason for this issue has been the lack of technology to navigate different healthcare unknowns. But that has changed now. There are already a couple of software tools that advisors are using. "People are very concerned about the rapidly rising costs of this essential service (healthcare) so it is critically important to us to address it proactively with our clients”, says Mark Haller, a financial advisor with Tacoma, WA based Summit Capital Advisors. “Rather than trying to work with fuzzy guesstimates, I use Retiree Healthcare Planner to work with client specific healthcare estimates. The numbers are sometimes shocking but they allow a basis for meaningful discussion and practical decision-making," adds Haller.

Health Trends

We've discussed a few key issues around healthcare expenses and their planning. Let's also briefly delve into some of underlying health trends among seniors that are leading to these issues. According to the Alzheimer's Association, over 5.2 million seniors (every eighth person) suffer from Alzheimer's, a number that could triple by 2050. Alzheimer's is only one of several leading causes of death. Other diseases, according to Centers for Disease Control (CDC), include cardiovascular disease, cancer, chronic respiratory disease, and stroke. They all may involve lengthy treatments and care.

The Center for Medicare and Medicaid Services puts the number of seniors having difficulties with three or more activities of daily living or ADLs (Bathing, Dressing, Eating, Getting in and out of bed/chairs, Walking, and Using a toilet) at 64%. It is not just the increase in the number of people suffering from diseases requiring long-term care alone that's affecting the healthcare system, people are also living a lot longer. According to the Social Security Administration, a man reaching age 65 today can expect to live, on average, for additional 13 years, or until age 83. A woman turning age 65 today, on the other hand, can expect to live on average, until age 85. In 1940, the life expectancy for a man at age 65 was an additional 13 years (78). A five year change is pretty significant and this increase doesn't necessarily mean five healthy years. About 44% of people reaching age 65 are expected to enter a nursing home at least once in their lifetime. Of those who do enter a nursing home, about 53% will stay for one year or more [Stillman and Lubitz, “Medical Care” 40 (10): 965-967]. The Department of Health and Human Services estimates 10 percent of the people who enter a nursing home will stay there five years or more. According to the American Association of Retired Persons (AARP), the lifetime probability of becoming disabled in at least two activities of daily living or being cognitively impaired is 68% for people age 65 and older.



64% Seniors have difficulties with 3 or more Activities of Daily Living [Source: Source: Center for Medicare & Medicaid Services]

So, how are people coping with these challenges currently? A small number of people are self insured and can afford expensive treatments and care. Those who have obtained protection through some form of long-term care insurance are able to have some or all of the long-term care cost taken care of. According to the American Long Term Care Insurance Association, in 2012 the long-term care insurance Industry paid about $6.6 Billion in benefits. Some 264,000 individuals were receiving long term care insurance benefit payments as of December 31, 2012. But this is a small fraction of people receiving care. in 2011 more than 15 million family members and friends provided over 17 billion hours of unpaid care that may amount to several hundred billion dollars of loss in personal income that may devastate many families. "Having been in financial planning for 31 years, I have seen clients run out of money because of longevity and poor planning," says Boise, ID based financial advisor Cheri Pinkerton CFP ® with The H Group Inc. "In one case a couple insisted they would not live past their 70s even though they had a history of longevity in both families. They wanted to enjoy their money and not leave it to the kids. They are currently in their 90s and have spent all their money except for the Social Security they receive each month. She has serious dementia and he's in poor physical health so now one of their sons has been forced to move in with them as their caregiver in addition to working full time," adds Pinkerton.

Continuing Care Retirement Communities (CCRC) are emerging to be an alternative to home health care and private nursing care. They are part independent living, part assisted living and part skilled nursing home. CCRCs offer a tiered approach to the aging process, accommodating residents' changing needs. Upon entering, healthy adults can reside independently in single-family homes, apartments or condominiums. When assistance with everyday activities becomes necessary, they can move into assisted living or nursing care facilities. CCRCs aren't cheap. For one, they require a hefty entrance fee that can range from $100,000 to $1 million, long-term care insurance, and ongoing monthly charges of several thousand dollars.

Healthcare Costs

According to most financial planners, healthcare is the single biggest expense during retirement. Therefore, it is important to carefully analyze this expense and incorporate it in a client's retirement income plan. Every year a few organizations come up with a number representing healthcare expenses during retirement. While this information influences people to think about healthcare expenses, one could argue about the applicability of a number. For example, not all people have identical health issues, life expectancy, or need for different types of care. Additionally, there is a huge variation in healthcare costs across the country. Consider this: according to John Hancock Cost of Care Survey (www.ltcfeds.com), the average cost of a private nursing home in Boston was $124,830 (in 2011) as compared to $63,875 in Phoenix, AZ. The cost for doctor visits and hospitalization also varies from place to place. As a result, a single number for healthcare expenses is less relevant. It is the utilization level of different healthcare services and place of those services that drive the cost. According to many physicians, the utilization of different healthcare services is based on one's lifestyle, current health, and family health history. So, while developing a client's retirement income plan, an advisor needs to carefully analyze these factors to estimate healthcare expenses during retirement. An advisor doesn't need to be a medical doctor to be able to run this analysis. With a basic understanding of the

Medicare program and a software program, you can get reasonable healthcare cost estimates. This analysis would also be helpful to advisors who help their clients decide on the type and amount of coverage for long-term care insurance or other insurance products.

Medicare Programs

Since Medicare is at the heart of healthcare for seniors, let's briefly touch upon the Medicare program. Medicare offers three programs to choose from: Original, Supplemental (Medigap), and Advantage. Medicare consists of four parts, each covering different benefits:
PART A, also known as the Hospital Insurance (HI) program, covers inpatient hospital services, skilled nursing facility, home health, and hospice care. Part A is funded by a tax of 2.9 percent of earnings paid by employers and workers (1.45 percent each). Most beneficiaries do not pay a monthly premium for Part A services, but are subject to a deductible and coinsurance.

PART B, the Supplementary Medical Insurance (SMI) program, helps pay for physician, outpatient, home health, and preventive services. Part B is funded by general revenues and beneficiary premiums (around $100 per month). Beneficiaries who have higher annual incomes pay a higher, income-related monthly Part B premium; Part B also has a deductible and coinsurance of 20%.

PART C, also known as the Medicare Advantage program, allows beneficiaries to enroll in a private plan, such as a health maintenance organization, preferred provider organization, or private fee-for-service plan, as an alternative to the traditional fee-for-service program. These plans receive payments from Medicare to provide Medicare-covered benefits, including hospital and physician services, and in most cases, prescription drug benefits.

PART D, the outpatient prescription drug benefit is delivered through private plans that contract with Medicare: either stand-alone prescription drug plans (PDPs) or Medicare Advantage prescription drug (MA-PD) plans. Individuals who sign up for a Part D plan generally pay a monthly premium. Those with modest income and assets are eligible for assistance with premiums and cost-sharing amounts.

We talked about the variation in the cost of healthcare services from place to place. While the cost of prescription drugs may not change from one place to another, some drugs could be very expensive. For example, Soliris from Alexion (ALXN) that treats a rare disorder in which the immune system destroys red blood cells at night, costs $409,500 a year. There may not be many people using Soliris. But drugs for more common diseases such as Provenge for prostate cancer and Lemtrada for multiple sclerosis could easily range between $20,000 and $100,000 for a one year's supply. It is important to note that the bulk of the prescription drug cost will be paid by Medicare if a person has taken Medicare Part D or Prescription Drug coverage. But one needs to pay for Part D insurance, deductible, and copay. Additionally, despite the implementation of Affordable Care Act, once you reach the annual limit of $2,800, you have hit the coverage gap referred to as the “donut hole,” and you are now responsible for the full cost of your drugs until the total you have spent for your drugs reaches the yearly out-of-pocket spending limit of $4,550 (for 2013). After this yearly spending limit, you are only responsible for about 5% of the cost of your drugs.

Medigap policies – also called Medicare Supplement Insurance – are sold by private insurance companies and help cover Medicare’s cost-sharing requirements and fill gaps with their coinsurance, copayments, and deductibles for Medicare covered services. Based on coverage options, there are fourteen Medigap policy types (A through N) to choose from. The cost of a Medigap policy varies by state and plan type.

There are still some uncertainties around the whole Medicare program. Over the long term, several factors – including rising health care costs, an aging population, a decline in the number of workers per beneficiary, and increasing life expectancies – will present fiscal challenges for Medicare. From 2010 to 2030, the number of people on Medicare is projected to rise from 47 million to 79 million, while the ratio of worker per beneficiary is expected to decline from 3.7 to 2.4. Total Medicare spending is projected to more than double from $545 billion in 2012 to $1,038 billion in 2020, according to the CBO. For many people long-term care cost will be their biggest healthcare expense during retirement and will continue to be an issue for most Americans irrespective of the fate of Medicare.

Affordable Care Act

Making Medicare affordable and sustainable is one of the goals for the healthcare law of 2010, also known as the Patient Protection and Affordable Care Act. Without going into the details of this law, perhaps we can look at some of its provisions as they relate to the Medicare program.

Many provisions of this law are implemented in phases over several years. For example,
- In 2010, provide a $250 rebate for beneficiaries who reach the Part D coverage gap.
- In 2011, begin phasing in federal subsidies for generic drugs in the Medicare Part D coverage gap (reducing coinsurance from 100% in 2010 to 25% by 2020) and thus gradually filling the 'donut hole'
- Beginning 2012, reduce rebates for Medicare Advantage plans and starting 2013, Part D enrollees will continue to receive a 52.5% discount on the total cost of their brand-name drugs while in the donut hole. The 50% discount is paid by the brand-name drug manufacturer and 2.5% paid by your Medicare Part D plan. Enrollees will pay a maximum of 79% co-pay on generic drugs while in the coverage gap.

Despite acrimonious political debate around Medicare, Medicaid, and other healthcare programs, there seems to be a broader understanding toward making government healthcare programs more and more means-tested. Even now certain Medicare payments are based on a person's income level. But in the future the scope of means testing is likely to broaden. The cost of long-term care would still be an issue. A long stay in a private nursing home could severely affect a financial and estate plan of a high net worth individual. Therefore, it is very important for financial advisors to educate their clients about potential healthcare expenses during retirement and account for such expenses in retirement income planning.

Opportunity for Financial Advisors

Planning for a major expense like healthcare during retirement is not only the right thing to do, it is also an opportunity for financial advisors to earn the loyalty of their clients. It is also not a difficult process. First, you need to familiarize yourself with the healthcare issues and the healthcare system. If you have read this article, you have already accomplished this to a large extent. Second, you need to educate your clients who are nearing retirement. Educating clients on healthcare costs may not be the easiest thing to do. If you haven't talked to them in past about healthcare costs during retirement, you don't want to give them a "sticker shock." Third, you need to use a tool to estimate a client's healthcare expenses and incorporate them in your client's retirement income plan. Finally, keep the information up to date as a client's health or financial situation may change from time to time.

Some financial advisors have already implemented processes to incorporate healthcare expenses into their clients' retirement income plans. "The first thing you must to do to prepare your baby boomer and older clients for healthcare expenses during retirement is to be willing to discuss it," says Brian Power, CFP®, Principal at Westfield, NJ based Gateway Advisory. "I find a lot of financial advisors are not willing to go down the path of discussing retiree healthcare expenses because they themselves do not know enough about the government retiree programs and they hope that the conversation doesn’t come up. The right approach is to familiarize oneself with Medicare, long-term care and the future of health insurance in our country. Power considers healthcare expenses to be a baby boomer client's "biggest challenge" in retirement. He uses retiree healthcare cost analysis to better engage clients as well as prospects.

Mike Peterson, CFP®, a financial planner with Chambersburg, PA based Tucker Financial Services, Inc says "I found that many of my retirement planning clients were either vastly underestimating the cost of healthcare during retirement, or worse yet, had not factored healthcare costs into their plans at all. I realized that I needed a good planning tool that could give my clients a realistic idea of what healthcare costs might be given their particular level of health, rather than relying upon one-size-fits-all rules of thumb. This approach has helped me better prepare my clients for dealing with real life retirement and has resulted in financial plans that are much more realistic and has reduced the risk of clients having a healthcare cost epiphany when it's too late in the game."

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