HEALTH CARE IN RETIREMENT

Many people planning for retirement tend to underestimate their potential health care costs. This is because many people assume that Medicare[1] will take care of all their medical needs. In reality, it is estimated that Medicare typically pays only 50 percent of a retiree's medical costs, and you might be surprised just how much money is actually needed to make up for the shortfall.

A 2009 Fidelity Investments study found that a 65-year-old couple should expect to need $240,000 over and above what Medicare provides.[2] This figure includes the premiums for Medicare Part B (doctor, out-patient, and other expenses) and Part D (prescription drug coverage), as well as Medicare out-of-pocket expenses, such as deductibles and co-pays. This figure does not include the cost of long-term care, which, according to a 2007 Genworth Financial survey, averaged about $96,000 annually nationwide. As the Fidelity Investments study points out, however, the problem with averages is that individual circumstances may result in costs above the average.

Compounding the problem is that inflation for health care costs is running substantially higher when compared with general inflation. This means that your medical costs will likely represent a greater portion of your retirement budget each year. This is why it is so important not to underestimate potential medical costs when you plan for your financial needs in retirement.

What are some ways you can plan for the cost?

Understand your employer-provided coverage. It is to your advantage to hold onto employer coverage as long as possible, even after age 65. Unfortunately, this may not be an option. The Employee Benefit Research Institute reported in 2008 that only 17 percent of private sector employers offer health insurance to retirees age 65 or older. Many employees mistakenly believe, however, that their employer will continue to provide health insurance after retirement. Even among employers who currently offer retiree coverage, many are reporting that this coverage will not be available to new retirees or that the retiree's share of the premium cost will be increased.

If your employer provides retiree health insurance as a benefit available to you after age 65, you need to determine if your coverage will replace or supplement Medicare. If your group plan is comprehensive, you will still be eligible for Medicare after you retire. To avoid a late enrollment penalty, however, you will have a limited time to sign up for Medicare Parts B and D after your group coverage ends.

If you expect to work part-time for your current employer during retirement, you should verify how many hours you will need to work to maintain your insurance coverage.

Keep working. Many employees who plan to retire early underestimate the cost of individual health insurance, which can run about $1,000 a month for a 60-year-old.[3] You and your spouse are not eligible for Medicare until each of you has reached age 65 or qualifies as disabled. If you retire prior to age 65, you and your dependents may be eligible for continued employer benefits under COBRA[4] but at an unsubsidized cost. The number of months you can retain COBRA coverage depends on your state. You can see why many early retirees depend on one spouse continuing to work to maintain an employer-provided health plan for the couple.

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Look into a health savings account (HSA). An HSA is a tax-advantaged savings account that, when partnered with a special high-deductible health insurance policy, can be used to pay for current and future medical expenses. Contributions to the savings account are tax deductible up to $3,000 ($5,950 per family) in 2009. HSA owners who are over age 55 may take an extra deduction up to $1,000. Withdrawals are tax-free when used for qualified medical expenses for you or your dependents, including long-term care, Medicare Parts B and D, or Medicare Advantage premiums.

Although contributions are not deductible once you become eligible for Medicare, the use of withdrawals from your existing HSA after age 65 is not restricted to paying for medical expenses. Distributions for nonmedical-related purposes will be taxed as income, however.[5]

Investigate long-term care insurance (LTCI). Although Medicare covers some medically necessary home health, skilled nursing, and hospice care, it does not pay for custodial care services, such as housekeeping. Nor does the program pay for prolonged care. Another government program called Medicaid will cover these costs but only for those seniors with very limited income and assets. A third alternative is an LTCI policy. It might seem prudent to delay buying this insurance until you need it, but if you wait until you retire, your health may preclude you from qualifying. Moreover, the premiums increase as you get older. The best time to buy LTCI is in your 50s and early 60s, or even earlier, when the premiums will be lower.

Price Medigap insurance or Medicare Advantage.[6] A Medigap policy is designed to pay for Medicare co-pays, co-insurance, and deductibles. It is also called Medicare Supplement Insurance and may be part of your employer-provided coverage. If not, individual policies are available. It pays to shop around, as you have a choice of several different standardized benefit packages with varying prices and options. You should buy your Medigap policy when you enroll in Medicare Part B to avoid denial due to poor health or late enrollment penalties.

Medicare Advantage (called Medicare Part C) is a private insurance program that includes HMOs, PPOs, and other health care alternatives. Medicare Advantage pays for Medicare Part A expenses, as well as the extras covered by Medigap and other benefits, depending on the carrier. Typically, Medicare Advantage covers vision, hearing, and dental exams, as well as prescription drugs and even wellness programs.

Dedicate a percentage of your retirement nest egg to medical expenses. Unless you plan for the rising cost of medical care in retirement, you may find your health care options, and your access to the best care, limited. Many experts recommend saving for retiree medical expenses in the same way you set aside money for your children's schooling, a home, or the retirement you have always dreamed about.

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[1] For more information on what Medicare provides, visit ***www.medicare.gov*** or the Kaiser Family Foundation at ***www.kff.org/medicare/7067/index.cfm.***

[2] The Employee Benefit Research Institute set this figure at $376,000 for the same 65-year-old couple, according to its May 2008 report, *Savings Needed to Fund Health Insurance and Health Care Expenses in Retirement: Findings from a Simulation Model.*

[3] Fidelity Investments offers a useful tool for estimating the average cost of COBRA or individual health care at different ages: ***https://powertools.fidelity.com/healthcost/intro.do.***

[4] For more information on COBRA, visit the U.S. Department of Labor at ***www.dol.gov/dol/topic/health-plans/cobra.htm***.

[5] For more information on HSAs, see the U.S. Treasury site at ***www.ustreas.gov/offices/public-affairs/hsa/pdf/all-about-HSAs_072208.pdf.***

[6] More information about Medigap and Medicare Advantage programs can be found on the government's Medicare site at ***www.medicare.gov/Publications/Pubs/pdf/02110.pdf.***