Modern retirement monthly

Healthcare in retirement | 7 August 2017

Chief Investment Office Americas, Wealth Management
Michael Crook, Head Americas UHNW and Institutional Strategy, michael.crook@ubs.com

- Most Americans have not accounted for healthcare expenses when planning for retirement.
- Healthcare expenses in retirement include Medicare premiums, deductibles, copays, and other out-of-pocket expenses.
- Our research indicates that a 65-year-old couple needs to have saved USD 300,000–600,000 at the start of retirement in order to cover future healthcare expenses.
- Healthcare costs are separate from long term care expenses and need to be planned for accordingly.

We would like to acknowledge Brandon Jusas, a summer intern in the Chief Investment Office, for his contributions to this report.

July 30th marked the 52nd anniversary of the creation of Medicare. Before Medicare, over half of seniors in the United States didn't have medical insurance. Today virtually all Americans over the age of 65 are covered by Medicare, but healthcare in retirement remains a complex topic. A recent study in *The Journal of Retirement*[1] found that only 12% of Americans have done specific planning for retirement healthcare expenses. Perhaps that's why UBS's most recent *Investor Watch* report, "Retiring old clichés," found that health is the top concern for retirees.

Our research indicates that a 65-year-old couple needs to have saved USD 300,000–600,000 at the start of retirement in order to cover future healthcare expenses.[2] Because healthcare costs are significant in retirement, it's easy to see how a combination of lack of planning, a misunderstanding of how Medicare works, and relatively high out-of-pocket costs can make otherwise-healthy retirement plans infeasible in practice.

We believe transparency can bring confidence to healthcare expenses in retirement. Our intention in this report is to provide the details necessary to kick-start the healthcare planning process.

Healthcare spending in retirement

One reason why many Americans fail to properly prepare for retirement healthcare costs is the assumption that Medicare will cover their expenses. Medicare participants are responsible for premiums, deductibles, and copays associated with Medicare parts A, B, and D, Medicare supplemental insurance, and dental insurance, as well as other out-of-pocket expenses. (See Appendix A for a more detailed discussion on the various components of Medicare.)

What does healthcare cost in retirement?

$300-600K

Amount a 65-year-old couple needs to have saved at the start of retirement to cover future healthcare expenses.

Based on CIO WM research.

Are Americans planning properly?

12% The number of Americans that have done specific planning for retirement healthcare expenses.

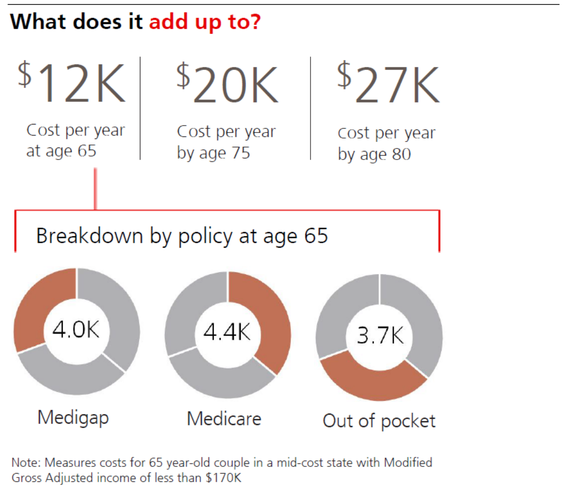
Source: The Journal of Retirement

What factors can impact cost?

State of residence

Higher income

What does it add up to? Expenses will vary based on your state of residence and income level, but today a 65-year-old couple living in a mid-cost state like North Carolina, with a modified adjusted gross income of less than USD 170,000, will find that annual costs run roughly USD 12,000 in the first year, reach over USD 20,000 per year by the age of 75, and climb past USD 27,000 per year by the time the couple turns 80 (Fig. 1).



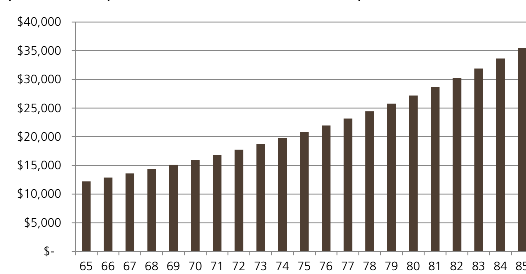
How does your state of residence impact your cost of healthcare?

Healthcare costs vary between states primarily due to higher out-of-pocket expenses for individuals who live in states whose Medigap policies do not cover prescription drugs (see Appendix A). While Medicare premiums are uniform across the United States, Medigap policies vary and can drastically increase the amount of out-of-pocket expenses some will face. These increased out-of-pocket expenses are attributable to those who require certain prescription drugs that are not covered under Medicare Part D and their Medigap policy, if they have one.

Generally speaking, those who live in states with higher costs of living should expect higher retirement healthcare expenses than those who live in states with lower costs of living. For example, while a couple in North Carolina may expect annual healthcare expenses at age 65 to be approximately USD 12,000, the same couple living in New York would expect to pay almost USD 16,000. This difference is attributable to higher Medigap policy expenses between the states. A state-specific analysis, completed as part of a financial plan, can provide cost estimates for your state of residence.

Fig. 1: Estimated healthcare expenses by age in North Carolina

Combined costs of Medicare, Medigap, and out-of-pocket expenses inflated at 5.5% per annum



Source: UBS, HealthView Services

How does your income impact your cost of healthcare?

Medicare premiums fluctuate based on your modified adjusted gross income (MAGI). Medicare defines MAGI as "one's adjusted gross income, plus these, if any: untaxed foreign income, non-taxable Social Security benefits, and tax-exempt interest."

Households with incomes above USD 170,000 will pay higher premiums for Medicare Parts B and D (Fig. 2). For instance, a household with annual income between USD 170,000-214,000 will pay the monthly USD 134 Part B premium plus an additional surcharge of USD 53.50 per month. Although it is estimated that only 5% of retirees pay surcharges on their Medicare premiums, all retirees should be aware of these surcharges when planning how and when they will receive income during retirement.

Fig. 2: Medicare Parts B and D premiums by MAGI

High income earners will pay higher Medicare premiums

Couple's MAGI level	Part B monthly premium	Prescription drug coverage monthly premium amount
$170,000 or less	$134.00	Your plan premium
$170k-$214k	$187.50	Your plan premium + $13.30
$214k-$320k	$267.90	Your plan premium + $34.20
$320k-$428k	$348.30	Your plan premium + $55.20
$428k and above	$428.60	Your plan premium + $76.20

Source: Social Security Administration

How much do you need to save for healthcare in retirement?

We can use a net present value (NPV) analysis to answer the following question: how much do retirees need to have saved, at the age of 65, in order to pay for their future healthcare expenses? Based on the data and analysis in this report, most retirees will need to have saved between USD 300,000 and 600,000 at the age of 65 to cover their healthcare expenses (Fig. 3).

In *Modern Retirement Monthly: Social Security: a longevity free lunch*, 6 July 2017, we pointed out that Social Security is worth upwards of USD 1mn for a retiring couple, which means Social Security should fully fund their healthcare expenses for current retirees. However, retirees have to account for those expenses in their overall plan, or they might not have as much discretionary income in retirement as originally expected.

It is also important to note that if you are not receiving Social Security at least four months prior to turning age 65, you will need to sign up with Social Security to enroll in Medicare Parts A and B. The late-enrollment penalty for Medicare Part A is 10% of one's monthly premium, and the penalty persists for twice the number of years a beneficiary could have been signed up for the program but failed to do so.

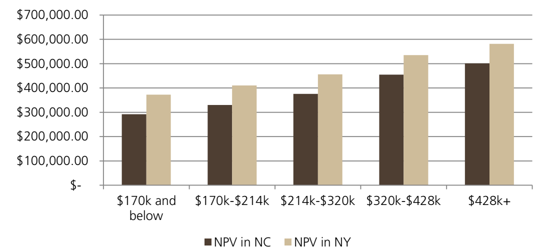
Healthcare cost inflation will likely remain elevated

A report by HealthView Services[3], a firm that specializes in healthcare cost projections, estimates healthcare cost inflation will average 5.5% per year (Fig. 4) over the next 7 years. The 5.5% overall estimate can be broken down as 3.57% for Medicare Part B, 8% for Medicare Part D, and 3.8% for supplemental insurance between 2018 and 2025. We expect broad-based inflation to average 2.4%, so retirees should expect their overall healthcare costs to increase twice as fast as other costs in retirement.

There are two inflation-based implications for planning. First, current retirees will likely see an increasing percentage of their Social Security benefits go toward medical expenses as they move through retirement, which means an ever-increasing portion of living expenses will have to come from other sources. Second, it's possible that 45- to 55-year-olds will find healthcare costs eat up most, if not all, of their Social Security benefits by the time they retire.

Fig. 3: Net present value of retirement healthcare expenses for a 65-year-old couple in NC and NY

Net present value of retirement healthcare expenses by MAGI level



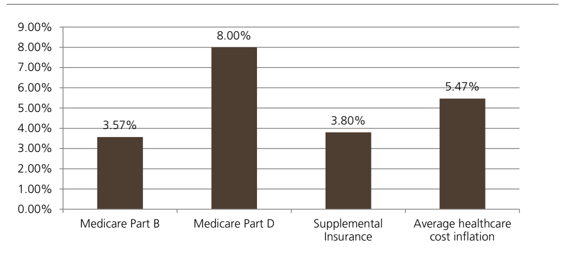
Source: UBS FGA

Will costs increase over time?

> Retirees should expect their overall healthcare costs to increase twice as fast as other costs in retirement.

Fig. 4: HealthView Services healthcare cost inflation

Predicted inflation from 2018 to 2025



Source: HealthView Services, UBS

Don't forget about long-term care

Healthcare and long-term care (LTC) need to be handled separately in the planning process. LTC services assist the elderly with personal and medical care. While many recipients of LTC receive medical support, not all LTC is medical in nature. Most LTC services help individuals with the basic tasks of everyday living.

Medicare doesn't cover the vast majority of LTC expenses. Medicare covers nursing home care if skilled nursing care (i.e., care that can only be provided by a registered nurse or doctor) is needed and then only for a limited time and with certain restrictions. For instance, Medicare covers up to 100 days of skilled nursing care if the patient enters the nursing facility within 30 days of a hospital stay that lasted at least three days. However, 100% coverage is only provided for the first 20 days, at which point the patient is responsible for a copay (USD 161 in 2016) that might be covered by a Medigap policy.

Our report, "Long-term care: What to do now," provides a good starting point for long-term care planning. You can find it at https://www.ubs.com/us/en/wealth/research/your-wealth-and-life.html or through your financial advisor.

Don't forget long-term care

LTC should also be incorporated into the retirement planning process.

Appendix A: Medicare basics

Medicare Part A covers stays in nursing facilities and hospitals beginning at age 65 and is free if the retiree paid the Federal Insurance Contributions Act (FICA) tax for 40 quarters. While premiums are free, retirees are responsible for copays and deductibles. The first 60 days of a hospital stay are fully reimbursed after a USD 1,316 deductible; the next 30 days have USD 329 copays per day, and a USD 658 charge is levied for "lifetime reserve day" after day 90. All in, a three-month stay in a nursing facility or hospital can cost USD 11,844 in out-of-pocket expenses for those enrolled in Medicare Part A.

Medicare Part B covers 80% of outpatient care costs, such as doctor visits and diagnostic tests. Part B premiums are income-based, and vary between USD 134 and USD 428.60 per month. The late-enrollment penalty for Medicare Part B is added to one's monthly premium, and can increase by as much as 10% per annum for every year the beneficiary could have been signed up for Part B but failed to do so.

Likewise, **Medicare Part D** covers prescription drugs and can be obtained by purchasing a Medicare prescription drug plan or by getting a Medicare Advantage Plan through a health maintenance organization (HMO) or preferred provider organization (PPO) that offers prescription drug coverage. Medicare Part D has premiums that vary based on the plan one chooses and the state they live in.

Additionally, Part D has a maximum deductible of USD 400 which includes copayments or coinsurance based on the type of Part D plan one purchases. The late-enrollment penalty for Medicare Part D is calculated by multiplying 1% of the "national base beneficiary premium" by the number of months one was eligible to enroll in Part D, but failed to do so. The national base beneficiary premium fluctuates each year, so the late-enrollment penalty may also change each year.

Outside of the Medicare program, Medigap policies are **supplemental insurance policies** sold by private companies and help pay for expenses not covered by Medicare, such as copayments and coinsurance.

[1] "Health State and the Savings Required for a Sustainable Retirement," Journal of Retirement, 2017

[2] Our cost estimates in this report were taken from the Financial Goal Analysis (FGA) planning tool. Cost estimates in FGA are determined by Jester Financial using the following sources: Centers for Medicare Services, Weiss Ratings, LLC, and the Bureau of Labor Statistics.

[3] HealthView Services 2017 Retirement Health Care Costs Data Report http://www.hvsfinancial.com/2017-retirement-health-care-costs-data-report/

Appendix

Disclaimer