How to Tame Health Care Costs When You Retire

Advance planning is critical and may help lower costs

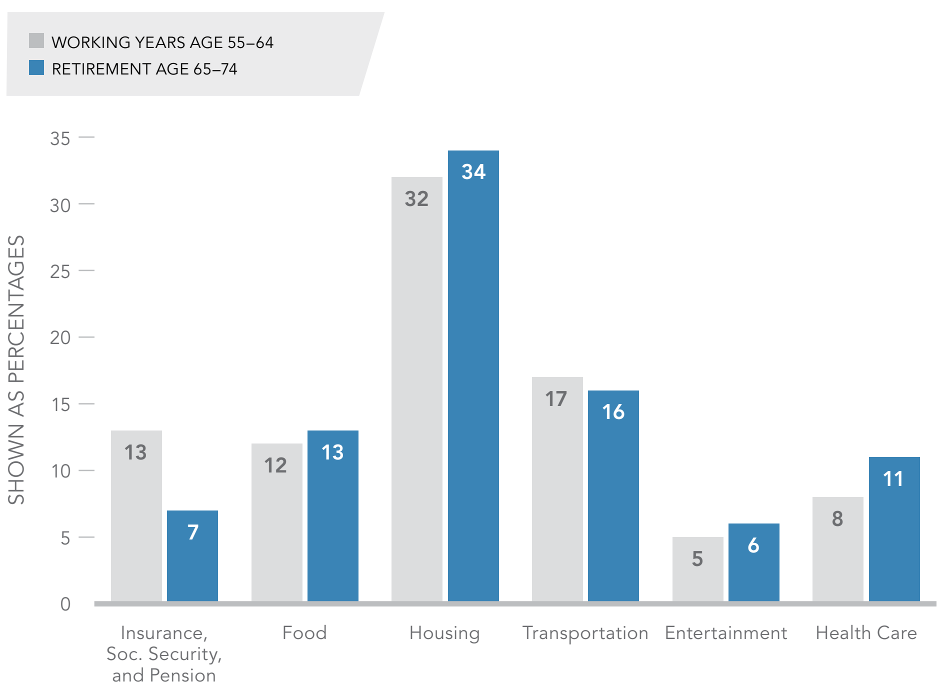
Most of us look forward to retirement as a time to shift gears, worry less, and enjoy a slower pace of life. But that rosy picture can quickly change and include some sticker shock as retirement nears, especially when it comes to paying for health care.

In a Fidelity survey,[1] nine in ten people approaching retirement said they were worried about outliving their savings due to the effect of inflation and the cost of medical care.

And no wonder. Health care costs have been rising at more than twice the rate of inflation, averaging 6.9% since 1960.[2] As the chart below shows, health care and housing are two expenses that continue to increase as retirees age.

THE REALITY OF RETIREMENT SPENDING

A look at consumer expenses



Source: Consumer Expenditure Survey, U.S. Bureau of Labor Statistics, September, 2012

Plan for rising costs and a longer retirement

Medicare program spending has increased an average of 6% annually for nearly a decade.[2] And, although Fidelity's estimate of medical costs in retirement has been relatively stable since 2013, health care costs in retirement remain a significant expense that must be planned for. Brad Kimler of Fidelity's Benefits Consulting business says, "Rising health care expenses are forcing people to make educated decisions now more than ever, ranging from the services they utilize to the age they choose to retire."

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 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.

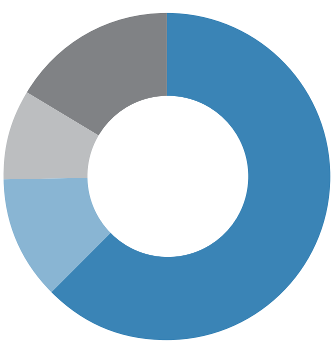
1. Understand Your Health Insurance Options

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 health care coverage behind. Today, only 25% of firms with 200 or more employees (and just 4% of small firms) still offer retirement health care coverage.[3] Even then, the plan may differ dramatically from its pre-retirement version. There may be different deductibles, co-pays, or other limitations, and you may be sharing a larger amount, or all, of the cost of the premium with your former employer.

SOURCES OF COVERAGE FOR ELDERLY HEALTH COSTS

Medical expense coverage sources for Medicare beneficiaries age 65 and over



Source: EBRI estimates from the 2011 Medical Expenditure Panel Survey. Percentages may not equal 100% due to rounding.

Medicare covers most retirees

While some people may have access to employer-provided retiree health care coverage, the government's Medicare health insurance is still the primary source of 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. Additionally, you can elect to purchase a Medigap policy for supplemental coverage.

Medicare Advantage plans combine Medicare Parts A and B and supplemental coverage into 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.

To cover prescription drugs, you can purchase Medicare Part D prescription coverage to supplement Medicare (Part A and Part B), or a Medicare Advantage Plan (i.e., HMO or PPO).

Although it can be time consuming selecting coverage to supplement basic Medicare from the many private insurance options available in your state, it 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 Medicare.gov and select "Find health & 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.

CHOOSE THE TYPE OF MEDICARE COVERAGE THAT IS BEST FOR YOU

Follow these steps to help you decide

	Step 1	Step 2	Step 3
Original Medicare	**Part A** (hospital insurance) & **Part B** (medical insurance) • Medicare provides this coverage. • You have your choice of doctors, hospitals, and other providers that accept Medicare. • Generally, you or your supplemental coverage pay deductibles and coinsurance. • You usually pay a monthly premium for Part B.	Decide if you want prescription drug coverage (**Part D**) • If you want this coverage, you must choose and join a Medicare prescription drug plan. • These plans are run by private companies approved by Medicare.	Decide if you want supplemental coverage • You may want to get coverage that fills gaps in original Medicare coverage. You can choose to buy a Medigap (medical supplement insurance) policy from a private company. • Costs vary by policy and company. • Employers/unions may offer similar coverage.
Medicare Advantage Plan (like an HMO or PPO)	**Part C** – Includes both Part A (hospital insurance) & Part B (medical insurance) • Private insurance companies approved by Medicare provide this coverage. • Most plans require use of plan doctors, hospitals, and other providers or you pay more or all costs. • Usually pay monthly premium (in addition to your Part B premium) and copayment for covered services. • Costs, extra coverage, and rules vary by plan.	Decide if you want prescription drug coverage (**Part D**) • If you want prescription drug coverage, and it's offered by your plan, in most cases you must get it through your plan. • If your plan doesn't offer drug coverage, you can choose and join a Medicare prescription drug plan.	• Note: If you join a Medicare Advantage Plan, you don't need a Medigap policy. If you already have a Medigap policy, you can't use it to pay for out-of-pocket costs you have under the Medicare Advantage Plan. If you already have a Medicare Advantage Plan, you can't be sold a Medigap policy.

Source: Medicare.gov, Your Medicare coverage choices, accessed July 2015.

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 a private 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.

Most online retirement planning tools 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 2014 would need $220,000 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. This figure covers the cost of insurance premiums for Medicare Part B coverage and Part D prescription benefits, plus out-of-pocket expenses for co-pays, deductibles, and miscellaneous home care costs. It doesn't include additional costs for treating chronic conditions such as heart disease, arthritis, diabetes, or most dental services.

It's also an average cost, to be used as a general guideline, because it applies to a 65-year-old couple retiring in 2014, 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.

Based upon currently available cost estimates, a retiring couple might need as much as $10,906 each year to pay for medical expenses not covered by Medicare, including premium expenses for a Medicare supplemental policy.[4]

Another consideration is that 70% of people who reach age 65 will use some form of long-term care.[5] You might want to earmark a portion of your budget for purchasing long-term care (LTC) insurance as well. 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, 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 sets aside pretax money to be used only for health care expenses (and can be withdrawn tax free), make sure you factor those assets into your planning calculations. On the other hand, if you haven't yet taken advantage of your employer's HSA-compatible health plan, think about using the health plan and an optional HSA to begin saving now on a tax-favored basis. Because you don't have to use money contributed to an HSA right away, it can be set aside to cover qualified medical expenses 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 Kimler. "HSAs have no 'use it or lose it' policies 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 Employee Beneficiary Association (VEBA) plans.** These are tax-favored trusts set up to provide health benefits to employees of school districts, higher education, 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 2014 EBRI Retirement Confidence Survey.[6]

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 Steven Feinschreiber, senior vice president of research at Fidelity Strategic Advisers, Inc. He and his colleagues completed an exhaustive study of the factors that influence the cost of health care in the United States. Their findings: Despite the complexity and confusion of health care pricing, it is possible to gather information on your health care product and service options so you can select those that offer the greatest value for your dollar.

For example, he says, take the case of someone who breaks his arm. An emergency room visit could run $2,000 or more and could take many hours, while an urgent care facility might cost $200 for the very same care. "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. For example, would an outpatient procedure be a safe, effective, and lower-cost alternative to an overnight stay in a hospital? Would an X-ray be as good as an MRI for the situation? Again, if you're paying a larger portion of the costs yourself with a high-deductible plan, these decisions do have an immediate effect on your wallet.

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 (and the eventual demise of the "donut hole"), prescriptions can cost thousands of dollars a year if you're treating a chronic condition.[7] 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, don't assume that your health plan's distributor offers the best price. Check your plan's drug "formulary" against local retail drug stores and discount superstores and look into the benefits of purchasing frequently used prescription medications in larger quantities online.

One other interesting finding is that health care costs vary widely by geographical region. "In general, costs are lower in the western and mountain regions of the U.S. and higher in the eastern and mid-Atlantic states," Feinschreiber reports. And the differences are even more dramatic by state than by region.

For example, Arizona's per capita personal health care expenses were 80% of the national average while New York's were 122% – a difference of 42%. While he agrees that most people won't relocate just to beat high health care costs, Feinschreiber suggests that people who are thinking about living in a different state during retirement should take these numbers into account. To learn more about state and regional cost comparisons, check the reports online at the Centers for Medicare & Medicaid Services.[8]

Finally, "Don't underestimate the link between your health and your financial wealth," says Patel. "It's important to know what you can do to influence your costs and to understand how your good health may play a role. If you have a chronic health condition already, make sure you manage it by making recommended doctor visits, using medications correctly, and completing lab tests, and then combine all of this with 'wellness' practices. Of course, if you're already healthy, do what you can so you stay that way."

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.

Covering health care expenses is a critical part of **retirement income planning**. Contact your advisor to help make sure your future is protected.

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1. Fidelity Advisor 2013 Survey of Investors at Retirement, July 2013. Conducted by Research Now on behalf of Fidelity Investments, this survey included 1,886 investors between the ages of 50 and 75 with investable assets of $100,000 or more. Fidelity Investments was not identified as the survey's sponsor.

2. Centers for Medicare & Medicaid Services, National Health Expenditures; Aggregate and Per Capita Amounts, Selected Calendar Years 1960–2011, http://www.cms.gov/NationalHealthExpendituresAggregate.

3. Kaiser Family Foundation, Employer Health Benefits, 2014 Annual Survey.

4. Based on a Medicare Part B premium of $1,259, $2,014 for annual premium and deductibles per beneficiary spending for Part D for 2015 from the Department of Health and Human Services, 2013 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, and a $2,180 Medigap Part F average premium from the Department of Health and Human Services, 2014 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

5. U.S. Department of Health & Human Services, National Clearinghouse for Long-Term Care Information, April 2014.

6. Employee Benefit Research Institute (EBRI), March 2014.

7. The Patient Protection and Affordable Care Act requires pharmaceutical companies to offer a 50% discount on brand-name drugs that fall into the so-called "donut hole." The Health Care and Education Reconciliation Act goes further to reduce out-of-pocket costs by phasing out the concept of the donut hole by 2020.

8. Centers for Medicare & Medicaid Services: Total All Payers Per Capita State Estimates by State of Residence 2014, and State Health Expenditure Accounts by Residence Location Highlights, http://www.cms.gov. Percentages were calculated by Fidelity.

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