ISSUE 11 | VOLUME 2 | MAY 2014

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An Overview of Health Insurance and Medical Expense Planning in Retirement

We have wanted to write a piece on healthcare costs during retirement, specifically planning for the cost of insurance premiums and medications, for months. There is an incredible amount of information available out there (some of it accurate!), so we understand that planning for healthcare costs in retirement seems like a daunting task. What we intend to do with this piece is to not give you every last bit of information that may be relevant to your specific situation because this newsletter would stretch on for pages and pages, but to give you at least an overview of the different Medicare and Medicare supplement components with an illustration of how much various choices could add up to over time. When it comes time to make retirement healthcare decisions, whether that means before or during your retirement, we advise you take the time to carefully estimate the long-term impact of your potential choices.

Medicare Part A - Hospital Insurance

Medicare Part A insurance partially pays for illnesses or medical conditions considered medically necessary which require inpatient stays in the hospital, but only for so long, and the costs passed to the patients increase the longer they stay in the hospital. Part A also partially pays for stays in skilled nursing facilities (after hospital stays), hospice care, and some skilled home health care. However, it does not pay for long-term or custodial care, and it does not pay for outpatient care.

You are eligible for free Part A coverage if you or your spouse paid into Social Security for at least 10 years. 99% of Medicare users do not have to pay premiums for Part A.

Medicare Part B - Medical Insurance

Medicare Part B insurance also partially pays for medically necessary doctor's office visits, outpatient clinic and hospital care, and other skilled services. It also covers an annual wellness exam plus additional preventive screenings. Part B is voluntary, but most people sign up when they first become eligible.

Part B comes with a monthly premium for which most retirees will pay $104.90 in 2014, but which can be as high as $335.70 depending on a retiree's income. You are first eligible for Part B coverage, in most circumstances, three months before you turn 65 through three months after you turn 65. If you do not sign up for Part B coverage in this initial period, you may have to pay higher premiums permanently if you sign up later.

Medicare Part C – Medicare Advantage

Medicare Part C combines Part A and Part B coverage, plus additional coverage that is not available under either Part A or Part B. Unlike Part A and Part B, Medicare Part C is provided by private insurance companies that are approved by Medicare and offered to Medicare recipients. An especially attractive feature of the Medicare Advantage program is that many of the insurance plans offer additional benefits that traditional Medicare does not cover. Unlike Traditional Medicare, most Medicare Advantage Plans also provide coverage for prescription drugs.

The premiums that you need to pay for a Medicare Advantage Plan may be significantly smaller than those you would have to pay for both a Medigap policy and for a Medicare Part D drug plan. Generally, the premium will be higher if the plan includes lots of extra things that are not already covered by Medicare Part A and Part B, like prescription drugs, dental care, wellness programs, vision care, or health club memberships. Additionally Medicare Advantage Plans can be PPOs, HMOs, Private Fee-For-Service plans, Medicare Medical Savings Account Plans, and Medicare Special Needs Plans.

Medicare Advantage plans also offer a yearly cap on the maximum amount you must pay out of pocket for Part A and Part B services, a feature which Original Medicare does not provide. Once you hit that limit, the plan pays for all covered expenses. In 2013, 48% of Medicare Advantage plans had a cap of $3,400 or less, according to the Kaiser Foundation.

Medicare Part D – Prescription Drug Insurance

Medicare Part D is a separate policy you buy from a private insurer which provides prescription drug coverage. You can get Medicare Part D in two different ways: by adding it to your original Medicare Plan (Parts A and B), or by adding it to your Part C (Medicare Advantage) plan, provided that the Part C plan that you have does not already offer prescription drug coverage. You do not need Medicare Part D if your Medicare Advantage Plan already provides prescription drug coverage.

Medicare Part D's costs may include some or all of the following: monthly premiums, deductibles, coinsurance, copayments, coverage gaps, and late enrollment penalties. In general, premiums can range from $0 per month for plans that have deductibles and may not cover as many medications, to $100 or more per month for plans that generally do not have deductibles and may cover around 95% of Medicare approved prescription medications. Regardless of premium costs, most plans include either a coinsurance amount or a copay amount for medications.

Estimating a person's annual prescription drug expenses is tricky considering all the different variables involved and the current structure of Medicare Part D, but in general a retiree pays either coinsurance (which means paying a percentage of the medication's cost) or copays (which means low fixed costs for each prescription filled) until the total money spent on medication by all parties equals an "initial coverage limit", which in 2014 is $2,850. So if you paid $500 and your insurance paid the other $2,350, that reaches the coverage limit. Once that amount has been reached, you will be paying 100% of the medications' prices until the total you have spent for the year reaches $4,550. Once you have spent that much out of pocket, Medicare Part D coverage kicks in again and pays at least 95% of the medications' costs after that point.

The little bit of good news here is that while in that coverage gap, or "donut hole" as it's called, you do receive a discount on brand name and generic drugs, and by 2020 there is no longer supposed to be a coverage gap; the out of pocket cost for both generic and brand name drugs will be reduced to 25% the manufacturer's cost after the initial coverage limit is reached.

Medigap

Medicare provides a lot of coverage, but it doesn't cover everything. Medigap is the name given to Medicare supplemental insurance policies that are sold by private insurance companies to fill in the "gaps" in the Original Medicare Parts A and B coverage, like deductibles, copayments, or coinsurance amounts or other limits under the Medicare program. These Medigap policies are not government-sponsored and are sold and administered by private insurance companies. However, Medigap policies are standardized and the policies all have specified sets of benefits so that you can compare them easily.

Medigap insurance policies are closely coupled to Original Medicare itself, and will only cover services that Original Medicare will also cove. All that Medigap does is to aid in covering some of the deductibles, copayments, and coinsurance that Original Medicare asks the patient themselves to pay. Medigap insurance policies will not cover medical services that Original Medicare itself does not cover, such as long-term care, vision or dental care, hearing aids, cosmetic surgery, health club memberships, or private-duty nursing care.

There are 10 standard Medigap plans, labeled A through N (with no E, H, I nor J, which were discontinued), that offer different levels of health coverage. Some of the plans offer high-deductible options for lower premiums. The most popular Medigap plans are F and C. It is important to compare Medigap policies, because premium costs can vary widely for identical levels of service.

In addition to the standard A-N Medigap policies, Medicare SELECT is a type of Medigap policy that can cost less than standard Medigap plans. Any of the standardized Medigap policies can be sold as a "Medicare SELECT" policy. However, Medicare SELECT plans are similar to HMOs or managed care programs where you are required to use "in-network" doctors and hospitals, and the insurance carrier will only pay full benefits if you get your medical care from providers who are in the insurer's network. In addition, plan participants will also need to get a referral from their primary care physician in order to see a specialist or to be admitted to the hospital for anything other than an emergency. If you venture outside the network, your SELECT plan might not pay the full amount or might even deny payment. However, if you do not use a Medicare SELECT doctor or hospital, basic Medicare will still pay its share of the costs (assuming that the provider accepts Medicare).

Comparison of 30 Years' Costs of Insurance Premiums and Prescriptions

To give a brief example of how different lifestyles, health situations, income levels and personal preferences can affect the long-term cost of health insurance premiums and prescriptions, consider two gentlemen named Cliff and Norm.

Cliff is retiring on a modest pension, has some retirement savings, believes he is in relatively good health and does not intend to travel overseas. He will trade annual savings for the potential that some years he may have to pay more out of pocket if he needs medical help because he assumes he will save more in the long run. He will pay the lowest Medicare Part B premium. He has chosen a Medicare Part D drug plan with a $20 monthly premium and a 20% coinsurance for his $250 per month medication, and he will have to pay the annual deductible of $310. Lastly, he has chosen an "L" Medigap Policy that doesn't cover everything, with no foreign travel emergency coverage, but does have an annual out of pocket limit of $2,300. Total annual premium and medication costs for him in 2014 are about $3,900.

Norm has no pension, but he has accumulated a large retirement nest egg which will push him up the tax brackets enough where he will pay a higher Medicare Part B premium of $210. He does intend to travel overseas while he can, although he does have some health problems that could become major someday. He has prescriptions totaling $500 per month. He has chosen a Medicare Part D plan with a $100 monthly premium because some of his medication is not covered by most plans, he will also have a 20% coinsurance payment, but he will not have to pay the annual deductible. He chose an "F" Medigap Policy because it covers all that Medicare doesn't. Total annual premium and medication costs for him in 2014 are about $7,900.

Diane, on the other hand, wants the extra services not covered by Medicare, like the dental and the vision benefits, so she has chosen a Medicare Advantage plan with drug benefits. She is not in a high enough tax bracket to pay extra for Medicare Part B, so she too will pay the minimum. Her PPO Medicare Advantage plan has a $124 monthly premium, and it also covers her prescriptions consistent with Medicare Part D. She has prescriptions that will cost her $45 per month in co-pays. She is hoping that her health remains as good as it has always been, as she has an annual out of pocket maximum cost of $3,400 In-Network and $5,100 Out-of-Network. She has a greater potential to be "nickel and dimed" than the other two, which will affect her out of pocket expenses the more doctors she sees. Total annual premium and medication costs for her in 2014 are about $3,300.

Assuming rates of inflation between 3 and 5% on the various premiums and costs, Cliff, Norm and Diane are estimated to spend the following amounts over the next 30 years on premiums and prescriptions:

	Medicare B Premiums	Prescription Drugs	Plan Premiums	Total
Cliff	$60,000	$58,300	$66,500	$184,800
Norm	$120,000	$131,500	$95,150	$346,650
Diane	$60,000	$25,700	$71,000	$156,700

Diane will have extra copays and extra annual out of pocket costs for any hospital and critical care stays, but as long as she remains in good health, she has a good chance of keeping her healthcare costs affordable, with a good chance of paying less than Cliff over the long term. Although he is paying more to get nearly everything covered, if Norm's health problems continue or worsen, he may end up saving money by not having to pay much beyond his premiums, as the extra copays and coinsurances present in Cliff and Diane's coverage would add up over time for him. In general, Medicare Select plans save money for people in good health, while Medigap plans that pay for the coinsurances and overages that traditional Medicare will not can save money for people in poor health.

Premiums and prescriptions are easy to game plan compared to care needs brought on by illnesses, accidents, and injuries. However, it is highly likely that over a twenty to thirty year period, especially as we age, we will face hospitalization needs. Therefore, make sure you take the time to work both those expenses which are easy to anticipate, like premiums and prescriptions, as well as an additional amount of "unforeseen" health expenses into your retirement planning.

Key Takeaways:

- There are a lot of different choices to make when considering health insurance in retirement. It makes sense to plan what costs you want insurance companies to cover, as well as how much of your nest egg you will need to consider dedicated to potential healthcare costs.

- In order to receive coverage under Medicare A and B the same month you turn 65, you need to sign up for them the three months before you turn 65. Otherwise, there will be a one month delay between when you sign up and when you are covered.

- Once you leave your job, you must enroll in Part B within eight months after the month you retire provided you are already at least 65, even if you continue to be covered by your employer's health plan or you may face delays in coverage and possible permanent premium increases.

- You must enroll in Medigap (A-N) coverage within 6 months of enrolling in Medicare Part B to guarantee coverage despite pre-existing conditions and avoid higher premiums.

- The cost of Medigap and Medicare Advantage policies can vary widely. There can be big differences in premiums that insurance companies charge for exactly the same coverage. Shopping around can save thousands of dollars during retirement.

- None of the options discussed in this piece address the costs of a potential long-term care stay. To cover those costs, people need long-term care insurance, or a bigger nest egg.