

# planperspectives » RETIREMENT INSIGHTS FROM MORGAN STANLEY SMITH BARNEY



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In a recent survey, only 13% of respondents reported high confidence in their ability to meet health care expenses.

## Retirement Planning: Health Care Costs

Preparing to take on the cost of your own care

Medical care will probably be one of your most significant expenses as you grow older. Recent estimates shed light on what that may mean for you.

Health care is a popular topic these days as President Obama and legislators seek significant reforms to the current system. It's easy to understand why this issue is getting so much attention: Spending on health care in the US is expected to total \$2.5 trillion this year—a total of \$8,160 per person—and insurance premiums are outpacing inflation and earnings, as shown in figure 1.<sup>1</sup> Costs and spending are rising because people are living longer, technology has made steady—and often costly—advances and more conditions are treated now because of new research and techniques.

Spiraling costs make health care a particularly challenging piece of the

retirement planning puzzle. And there are other important questions to consider. How long will you live? How healthy will you be? What kinds of reforms might get passed? Given the combination of many forecasting variables and challenging markets, it is no surprise that a recent retirement confidence survey showed that only 13% of respondents were “very confident” that they would have enough money to take care of medical expenses in retirement.<sup>2</sup>

Many people don't have a good handle on what their health care costs are now—never mind what they will be in retirement. If your employer provides health care coverage, you may be one

<sup>1</sup> *Health Care Costs: A Primer*, The Henry J. Kaiser Family Foundation, March 2009.

<sup>2</sup> *Retirement Confidence Survey*, Employee Benefits Research Institute, April 2009.

of those people who hasn't looked in detail at the full costs in the present and expected costs to come. It used to be that you could count on your employer to foot the bill for health care costs after you retired, but fewer companies are giving employees this option. For many firms, the expense of covering future health costs has become onerous.

There are good research resources which have guidelines to help you figure out how much to set aside for health care costs. The Employee Benefits Research Institute (EBRI) recently updated forecasts

of health care spending using several sets of assumptions. The forecasts for two scenarios are summarized here.<sup>3</sup> Long term care is not factored in with these estimates, and it is assumed that people will not take Medicare before they become eligible at their normal retirement age.

**Scenario 1. A 65-year-old individual supplements Medicare benefits with retiree health benefits from a former employer, and the premiums are subsidized by the former employer.**

A man would need \$68,000 in current savings to provide a 50% chance

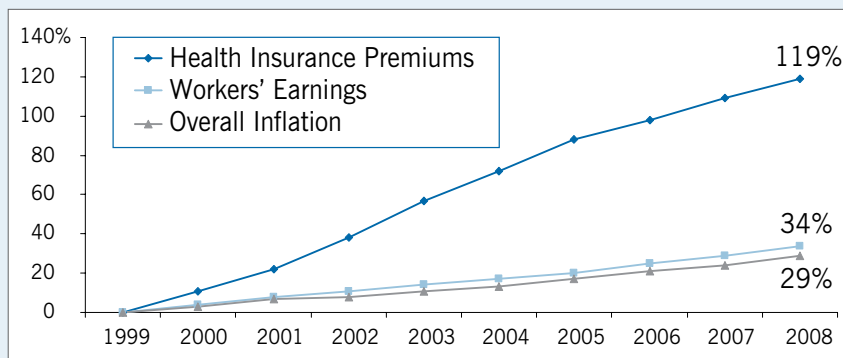
of having enough money to cover health care expenses in retirement, or \$134,000 in current savings for a 90% chance of having enough to cover retiree health costs. Since a woman is likely to live longer, she would need current savings of \$98,000 (50% chance), or \$164,000 (90% chance). A married couple would need current savings of \$165,000 (50% chance), or \$256,000 (90% chance).

**Scenario 2. A 65-year-old individual supplements Medicare benefits with retiree health benefits from a former employer, but the premiums are not subsidized by the former employer.**

A man would need \$111,000 in current savings to provide a 50% chance of having enough money to cover health care expenses in retirement, or \$217,000 in current savings for a 90% chance. A woman would need current savings of \$159,000 (50% chance), or \$266,000 (90% chance). A married couple would need savings of \$268,000 (50% chance), or \$414,000 (90% chance).

The range is wide. And deciding which estimate to use will depend on how well prepared you can afford to be. But the conclusion is inescapable: Health care costs will have a material impact on your budget in retirement. As a result, you should plan ahead and save accordingly. ■

**FIGURE 1: CUMULATIVE CHANGES IN HEALTH INSURANCE PREMIUMS, INFLATION AND WORKERS' EARNINGS, 1999 to 2008**



Data Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999 to 2008. Bureau of Labor Statistics, Consumer Price Index, US City Average of Annual Inflation (April to April), 1999 to 2008; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1999 to 2008 (April to April).

<sup>3</sup> Savings Needed for Health Expenses in Retirement: An Examination of Persons Ages 55 and 65 in 2009, Employee Benefit Research Institute, June 2009.

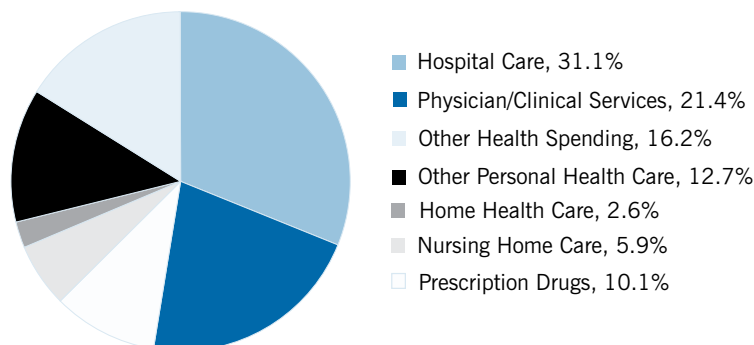
# Health Care in the US Economy

## Growing Fast

**>>** Health Care spending continues to rise.

Several decades of strong increases in health care spending mean that the sector accounts for a growing share of US economic activity. Health care accounted for 16.2% of gross domestic product (GDP) in 2007, up from 7.2% in 1970. Health care costs have grown, on average, 2.4 percentage points faster than the GDP since 1970. This year, health spending is estimated to account for 17.6% of GDP.<sup>4</sup> ■

**FIGURE 2: DISTRIBUTION OF NATIONAL HEALTH EXPENDITURES, BY TYPE OF SERVICE, 2007**



Note: Other Personal Health Care includes, for example, dental and other professional health services, durable medical equipment, etc. Other Health Spending includes, for example, administration and net cost of private health insurance, public health activity, research, and structures and equipment, etc.

Data Source: Kaiser Family Foundation calculations using NHE data from Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, at <http://www.cms.hhs.gov/NationalHealthExpendData/> (see Historical; National Health Expenditures by type of service and source of funds, CY 1960 to 2007; file nhe2007.zip).

### WHAT IS MEDIGAP?

A Medigap policy is private health insurance that is designed to supplement Medicare. Medigap helps pay some of the health care costs that Medicare doesn't cover such as copayments, coinsurance, and deductibles. Each standardized Medigap policy must offer the same basic benefits, no matter which insurance company sells it and it must be clearly identified as "Medicare Supplement Insurance." In some states, you may be able to buy another type of Medigap policy called Medicare SELECT, which is a Medigap policy that requires you to use specific hospitals and in some cases specific doctors to get full benefits. For more information, see "Choosing a Medigap Policy: A Guide to Health Insurance for People with Medicare" published by the Centers for Medicare and Medicaid Services. ([www.medicare.gov/publications/pubs/pdf/O2110.pdf](http://www.medicare.gov/publications/pubs/pdf/O2110.pdf))

<sup>4</sup> *Health Care Costs: A Primer*, The Henry J. Kaiser Family Foundation, March 2009.

# Savings Strategies

## Longer Life, Higher Medical Bills



Men and women in the US are living longer.

Longevity is one reason you need to plan thoughtfully for health care expenses. Life expectancy in the US is now 75 years for men and 80 years for women.<sup>5</sup> However, the longer you live, the longer you are likely to live relative to the average life span. As shown below, the life expectancy for a man who lives to age 70 is 84 years old. A 70-year-old woman is likely to live to the age of 86. ■

**FIGURE 3: AVERAGE LIFE EXPECTANCY OF MEN AND WOMEN IN THE US (IN YEARS)<sup>5</sup>**

Average Life Expectancy in Years		
Current age	Men	Women
50	28.8	32.5
55	24.7	28.0
60	20.7	23.8
65	17.0	19.7
70	13.6	15.9
75	10.5	12.3
80	7.8	9.3
85	5.7	6.8
90	4.1	4.8
95	2.9	3.3
100	2.0	2.3

<sup>5</sup> National Vital Statistics Reports Volume 57, Number 14 (Table 7), April 17, 2009.

### HOW HEALTH SAVINGS ACCOUNTS WORK

Some employers offer workers a Health Savings Account (HSA). This is a useful tool to help you manage current and future health care expenses. Money in one of these accounts can be used to take care of co-pays and deductibles and other qualified medical expenses on a tax-free basis.

As of August 2009, individuals can contribute up to \$3,000 to an HSA; the contribution limit for a family is \$5,950. If you are 55 or older, you are allowed a \$1,000 catch-up contribution. To set up an HSA, you must participate in an insurance plan that has a deductible of at least \$1,150 for individuals or \$2,300 for a family. Rules for HSAs are subject to change, so be sure to check with your employer.



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