



Undermining the golden years

Healthcare Costs Can Drain Retirement Savings

By almost any estimate, healthcare costs after retirement will constitute a significant expense for future retirees. The Employee Benefits Research Institute (EBRI) concluded that individual circumstances could result in variations of actual need for a 65-year-old who retired in 2004 ranging from \$72,000 to \$580,000 to pay for healthcare. By 2014, a 65-year old retiree can expect to need between \$137,000 and \$1.5 million for health expenses. Variation is based on differences in longevity and assumptions about the rate of increase in health care costs.

Fidelity Investments was scarcely more encouraging. That firm projects a couple retiring now at age 65 without access to employer-provided health coverage will pay \$190,000 for out-of-pocket medical expenses. That assumes a life expectancy of 15 years for men and 20 years for women. Added longevity increases anticipated healthcare costs. In addition, approximately half of retirees that reach age 65 eventually need nursing home care, which is not covered by Medicare or its usual supplements.

While Medicare covers many medical expenses for retirees once they are eligible, it doesn't cover everything. As a result, the

AARP Public Policy Institute found the average non-institutionalized Medicare beneficiary 65 or older spent \$3,455 on health care in 2003. Of that, 45% went to pay for premiums on Medicare Part B, private Medicare plans, and private supplemental insurance. The research also indicated that out-of-pocket expenses are affected by both the age and health status of the beneficiary. Not surprisingly, older retirees and those whose health is less robust spend more.

For retirees who do not receive continued health benefits from their former employers, a privately purchased Medigap policy provides one means for bridging some expenses that Medicare does not cover. Premiums for such policies differ by state and vary depending not only on where the retiree lives but also on the level of coverage selected. According to Weiss Ratings, the average cost of these plans in 2004 varied from \$1,113 to \$3,324.

Although increases in medical costs are expected to moderate for the near term after several years of double digit inflation, costs seem certain to keep moving upward. Recent research indi-

cates that health spending will continue to grow more rapidly than gross domestic product (GDP). As a result, its share of the GDP will rise from 15.3% in 2003 to 18.7% in 2014. In addition, private health insurance premiums per enrollee are expected to continue growing at a rate that outstrips growth in per capita disposable income, as they have done in the recent past.

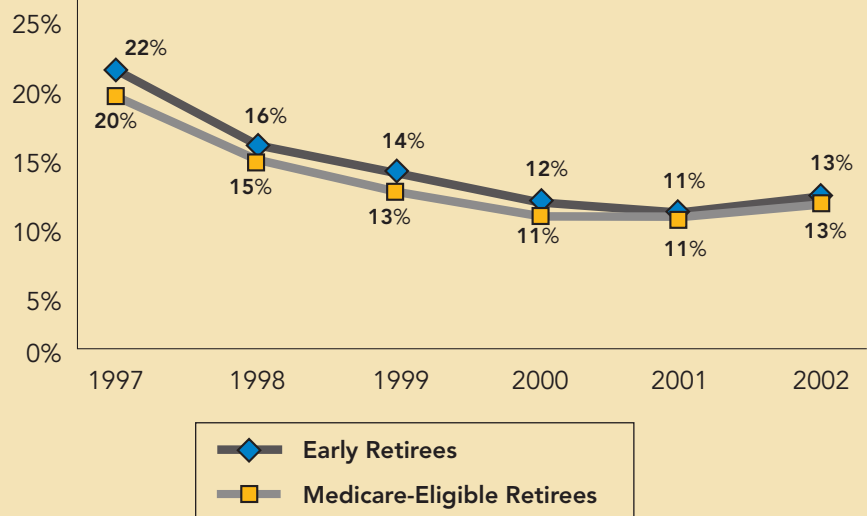
Only 8% of credit unions currently offer retiree health insurance according to CUNA Vice President of Research Services Vicki Joyal. That may be slightly worse than overall figures for private sector firms, 13% of which offered benefits to retirees in 2002 according to EBRI. However, retiree insurance coverage has been on the decline as an employee benefit. Based on EBRI data, as recently as 1997, 20% of Medicare-eligible retirees (those 65 or older) and 22% of younger retirees received health insurance benefits from their former employers.

Given the expected increase in demand for retiree health coverage as leading edge baby boomers reach eligibility for early retirement under Social Security in 2008 and then achieve eligibility for Medicare in 2011, concern about how to handle medical expenses after retirement will be a hot topic for the foreseeable future. While there may be increased pressure on employers from older workers who want health benefits continued into retirement, the trend is in the opposite direction. A number of firms that traditionally offered retiree health benefits have announced plans to discontinue them for new hires and current employees young enough to have time to make alternate arrangements for financing their retirement health needs.

In addition, many firms that continue to provide healthcare benefits to retirees are capping costs on coverage. While caps can be structured in a variety of ways, the result is that price increases beyond whatever threshold the plan sponsor sets are passed through to the retiree.

Some observers view Health Savings Accounts (HSAs) as an answer for helping workers build funds to help meet their medical care expenses after retirement.

Private Sector Establishments Offering Health Insurance to Retirees



Source: EBRI (various tables from Medical Expenditure Panel Survey)

While funds in HSAs can accumulate tax free, the accounts are not a panacea.

Contributions to HSAs are limited to \$2,650 for an individual or \$5,250 for a family in 2005. Savings in the account, which must be combined with a High Deductible Health Plan (HDHP), are reduced by the insured's payment of medical expenses before the deductible is met and by qualifying out-of-pocket medical expenses, leading to the criticism that such accounts favor the healthy.

A second criticism of HSAs is that lower-wage employees may not participate because they are unable to fund the account, much as lower-wage employees may not hold Individual Retirement Accounts because they feel incapable of funding them. An employer may, however, contribute to an employee's HSA. Even with such contributions, the combination of an HDHP and HSA can be more economical for an employer than a traditional health insurance plan.

Although they are relatively rare today, HSAs are poised for rapid growth. Almost half of the large employers that participated in one recent survey said they were considering making the plans available. Forrester Research has projected that participation could climb to

more than six million in 2008.

At the executive level, in the absence of retiree health insurance, some credit unions are exploring the use of Supplemental Executive Retirement Plans (SERPs) as a means to provide valued long-term executives with an additional income stream that will help to protect against healthcare cost inflation. While SERPs have been used as a retention and retirement funding vehicle within the industry for several years, increased understanding of the threat rising health costs present has moved additional employers to explore this means of securing the financial future for key personnel.

"Plan ahead," is great advice for those just beginning their credit union careers. Meanwhile, those whose careers are winding down must develop strategies to ensure their own financial well-being. With creativity, their employers can assist them in meeting this challenge.