Aligning Medicare, Healthcare in Retirement, and the HSA

The reality of healthcare costs in retirement and what employers can do to help.

By Karin Rettger and Pat Jarrett

Ten thousand baby boomers are retiring every day and they are in for a shock when it comes to healthcare. The problem of paying for retirement healthcare expenses is a multi-facetted problem. It is characterized by ever-increasing healthcare costs, minimization of the problem, and inefficient and insufficient savings.

Health care costs are one of the most significant and least understood challenges faced in retirement. Many people still believe that Medicare is free and that is covers most costs. The fact is Medicare covers only a portion of retirement healthcare costs. This article will take a look at the actual costs of healthcare in retirement and ways that employers can help employees prepare.

The Reality of Healthcare Costs

There are many different types of Medicare plans and each covers different items and have varying deductibles. An overview:

Medicare Part A: Covers inpatient hospital costs, stays in skilled nursing facilities, home health care visits, and hospice care. Most beneficiaries pay no premium for Part A, but there is a deductible of $1,184 this year (2018) for inpatient hospital stays.

Medicare Part B: After a deductible of $147, Medicare part B covers 80 percent of the cost of doctor visits, outpatient services, preventive care and some home health visits.

- Medicare Part B is not free. It charges a premium based on your income.
- The minimum premium is $134/month and it increases to as much as $428/month.

Medicare Part D: Covers prescription drugs. Part D is a complicated program that may have a yearly deductible, copayments for drugs (like a prescription drug card), and may have a coverage gap (donut hole) until your drug charges exceed $5,000 in out-of-pocket costs. Part D coverage varies by provider, but it charges an average monthly premium of about $40/month — if your income is above $85,000 (if single), Medicare charges an additional premium that can add $12 – $77 per month to the cost.

Medicare Part C (Medicare Advantage Plan): Only available in certain geographic areas, but if chosen, it acts as a replacement for Medicare, and Parts A, B, and D. It can often be a more affordable total package. Premiums vary by plan.

What costs are generally not covered by Medicare?

As we noted above, Medicare Part A, and Part B have deductibles and copays. Some people purchase a Medicare Supplement (Medigap) Policy to cover what Medicare does not cover. Medigap policies are standardized plans distinguished by a letter Plan A to Plan N (in most states) and each plan is a little different. In 2016, the average premium for Plan F (one of the most common plans selected) ranged from $130/month to $218/month for a 65-year-old male. The rates vary by geographic area.

Some of the other expenses that are typically not covered by Medicare or Medigap Policies include: Long-Term Care, Vision Expenses related to eye glasses, glasses, Dental Care, Dentures, and Hearing Aids.

For a full list of what Medicare and Medigap covers visit www.medicare.gov.

Health Care Costs in Retirement

If we add up the monthly premium costs of Part B, D, and Medigap, most retirees will find coverage will cost AT LEAST $325 per month (on average). When we translate what is not covered by Medicare into real dollars the scope of the problem becomes more apparent. The 2018 study done by Fidelity of retirement healthcare costs estimates that the average retired couple will pay $280,000 above and beyond Medicare. And to make matters worse, the study does not include over-the-counter medications, dental services, or long-term care expenses.

And, being healthy is no comfort — your overall expenses will typically be higher. That's because a significant portion of these expenses are insurance premiums, and the healthier and longer you live the more premiums you will pay.

The same Fidelity study mentioned above found that 33 percent of early retirees admit to having no idea what their healthcare costs would be. Those that were brave enough to hazard a guess were way off (46 percent thought less than $100,000). It is no wonder that one of the greatest fears facing retirees is how to pay for healthcare; it is a near total unknown.

Funding Healthcare Costs in Retirement

Today, Retiree Health plans are almost as rare as CD players and rotary phones. Only about 23 percent of large employers still offer a plan. As a result 49 percent of retirees are using personal savings to fund healthcare costs. Health Savings Accounts (HSAs) can be a big help.

Positioning the HSA as a Retiree Medical Plan

As a plan sponsor, you can position the HSA as an additional source of retirement income allowing it to operate like a Health Care 401(k). HSAs offer Federal, State, and FICA tax savings on the contributions invested in an HSA (when a 125 plan is the conduit). HSA account balances can be used tax free for medical expenses, including Medicare Part B and D premiums. In this way, an HSA is far superior to using 401(k) savings to fund medical expenses. If started early in one's career when medical expenses are typically low, it is possible to fund the HSA sufficiently to reach or exceed the expense numbers predicted in the Fidelity study.

Employers can help their employees effectively save monies in an HSA in three ways

- **Employer contributions:** Many employers are contributing to HSAs to help fund unexpected health care expenses, and to provide another funding source for retirement.
  - Some employers are accomplishing this by supplementing or diverting a portion of the 401(k) match dollars.
  - Some employers are using the premium savings from the HDHP.
  - Some employers are coupling the contribution to wellness participation.
- **Shoe-boxing:** As of today, there is no time limit on when a HSA holder can reimburse him or herself for previously incurred expenses. This means that participants who choose to use non-HSA funds to pay for eligible medical expenses they incur today can hold on to those receipts (commonly called "shoe-boxing" receipts). This allows the funds in the HSA to stay on deposit, potentially using the investment options in the HSA to further their growth (just like in your 401(k), the investment may gain or lose depending on the underlying investment performance).

  For Example: Throughout 20 years, you accumulate a $125,000 balance in your HSA by paying medical expenses with non-HSA funds, but save the receipts for those expenses, which total $25,000 over the years. In your first year of retirement, you can choose to reimburse yourself for ALL of those expenses and effectively give yourself $25,000 of tax-free income in that one year.
- **Education on contributing to both a 401(k) and an HSA:**
  a. Contribute the amount necessary to receive the maximum match in the 401(k).
  b. Contribute any additional savings over this amount to the HSA until the HSA maximum is achieved.
  c. Return to the 401(k) plan if you still have room in your maximum allowable contribution to maximize the 401(k) contribution.
  d. Your 401(k) Advisor might be a source to conduct the education, and to make sure this strategy does not impact your 401(k) testing.

Smart plan sponsors are re-thinking how to position the HSA in this way. Not every employee will be able to max-out the HSA, just as most do not max-out their 401(k), but saving in both, when possible, can provide the best outcomes for employees in regards to healthcare costs in retirement.

HSAs and Other Medical Plans

Remember, if someone is covered by any other medical plan including an FSA or Medicare, they are not eligible to contribute to an HSA. Since employers do not always know if an employee is participating in another health plan or in Medicare, this can easily be overlooked. Determining eligibility for an HSA is the responsibility of the employee, but plan sponsors may want to include it in their plan education.

Summary

As we have discussed, there is a lack of education and understanding around Medicare — educating your employees about Medicare prior to retirement will help better prepare them for healthcare costs in retirement. Healthcare costs in retirement are often overlooked as a part of a comprehensive retirement plan but employers can help bridge this gap by increasing adoption of HSA plans. If you have not done so already, consider shifting to an HSA-qualified health plan (HDHP), and:

- Begin describing health care savings and the health savings accounts as part of a comprehensive retirement strategy.
- Educate, educate, educate on true cost and the various alternatives for funding retirement healthcare costs.
- Encourage HSA adoption and savings.
- Make an employer contribution to the HSA.

With these strategies, we believe your employees will increase their financial future for a successful retirement.

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