Financing Health Care in Retirement: A Day Late and a Dollar Short?

A Discussion Featuring:

Dallas Salisbury
President and Chief Executive Officer
Employee Benefit Research Institute

Stan Hinden
Journalist and Author

Location
Washington Court Hotel
525 New Jersey Avenue, NW
Springwood Room

Registration Required
Space is limited. Please respond as soon as possible.
Send your contact information by e-mail to: nhpfmeet@gwu.edu
Financing Health Care in Retirement: A Day Late and a Dollar Short?

OVERVIEW

This Forum session will review projections of health care expenses in retirement and examine the ability of current and future retirees to finance these expenses. The outlook for factors that affect financial security in retirement, such as retiree health benefits, savings rates, and Medicare financing, will be reviewed; the effectiveness of various savings vehicles, such as health savings accounts, to meet the challenge of saving for health care expenses in retirement will also be discussed. A consumer perspective on how current retirees are coping with health care expenses will be offered.

SESSION

Threats to financial security in retirement have been much in the news lately. Bankrupt U.S. airlines such as United and U.S. Airways have turned over their pension obligations to the Pension Benefit Guaranty Corporation, and other large employers, including IBM, Verizon, and Hewlett-Packard, have “frozen” their defined benefit pension plans for parts of their workforce. At the same time, employment-based retiree health benefits—another source of financial security in retirement—continue to erode, particularly for future retirees. Those already retired who have health care coverage are not immune; a growing number of retirees are being asked to pick up more of the costs of their care through higher premiums, deductibles, copayments, and coinsurance.

Although most of the recent media attention has focused on the impact of pension changes on workers’ prospects in retirement, current and future health care costs also threaten financial security in retirement. Health care costs have consistently risen at rates above inflation, and premiums for employer-sponsored insurance rose nearly three times faster than wages in 2005. Total health care spending as a percent of gross domestic product, currently 16 percent, is projected to reach 18.7 percent by 2014.

Whether retirees can count on government programs to fill in likely gaps between savings and health care expenses is not clear. Medicare currently pays about 53 percent of health care costs for beneficiaries age 65 and over. However, in their 2005 annual report, the trustees of the Social Security and Medicare trust funds noted that Medicare will be in financial trouble sooner, and more severely, than Social Security. Assets in the
Hospital Insurance (HI) Trust Fund will drop below the level of projected expenditures as early as 2014; the HI Trust Fund is expected to be exhausted by 2020. Moreover, the trustees point out that paying for both Part B physician services and the new Part D drug benefit “will require substantial increases over time in both general revenue financing and premium charges.” Taken together, these trends and projections suggest that more and more of the risk for financial security in retirement will be shifted to workers and retirees.

The impact of rising health care costs on achieving financial security in retirement is likely to be significant. Researchers at the Employee Benefits Research Institute (EBRI) estimate that (depending on assumptions about the type of coverage, life expectancy, health care inflation, and rate of return on savings) individuals retiring in 2014 and living to age 80 or 90 could need as much as $151,000 to $754,000 to cover their health care expenses such as employer-sponsored insurance or Medigap premiums, Medicare Part B and D premiums, and out-of-pocket costs. It is important to note that these figures do not include the costs for long-term nursing home care, which now average over $70,000 annually.

These projections suggest that financing health care in retirement will create substantial savings challenges for future retirees. Fidelity Investments estimates that those “baby boomers” turning 60 in 2006 will have an average of $112,000 in their 401(k) accounts. In retirement, this cohort is on track to receive only 60 percent of their pre-retirement income, well below the 85 percent recommended by the investment firm. An analysis by Hewitt Associates of retirement data from 67 large employers concluded that retirees who want to maintain their pre-retirement spending patterns will actually need to bring in over 100 percent of their pre-retirement income, largely due to retiree medical costs. And while 66 percent of workers participating in the EBRI Retirement Confidence Survey believe they will be able to achieve their savings goals by the time they actually retire, most have not even tried to estimate what they will need in retirement, and over half say their savings plans are behind schedule. The fact that the personal savings rate—a negative 0.7 percent of disposable income in December 2005—is at a 73-year low does not bode well for future retirees. For many, a savings gap is almost certain.

How will workers save for future health care expenses in retirement? Health savings accounts (HSAs) authorized under the Medicare Modernization Act of 2003 might help younger workers build up balances that could be used in retirement. But their potential benefit for middle-aged and older workers—who have few years to contribute and who are most likely to use all or part of the money in their HSAs annually to pay for out-of-pocket medical expenses—is likely to be negligible. Other funding vehicles, such as retiree medical accounts (RMAs) and voluntary employee benefit associations (VEBAs), are not widely available and have significant drawbacks due to their design.
KEY QUESTIONS

■ What is the outlook for employer-sponsored retiree health benefits in the future? How much will people retiring in the near future be able to count on these benefits?

■ What is the impact of health care cost inflation on projected income or savings needs in retirement?

■ Baby boomers are counting on Medicare to finance a significant portion of their health care needs in retirement. How would retirement income needs be affected if Medicare financed a slightly smaller share of health care expenses?

■ How do projections for financial security in retirement change when long-term care expenses are included? What fraction of future retirees can amass sufficient savings to deal with expensive long-term chronic illnesses?

■ How do pre-retirement expectations about health care needs in retirement match the reality? Are retirees needing to return to the labor force to help pay for health care needs? Will baby boomers need to delay retirement to help boost their savings for health care expenses?

■ What options do younger workers have for accumulating savings to meet their health care needs in retirement? What options do middle-aged and older workers have?

■ The erosion of employer-sponsored retiree health benefits and the likely gap between savings and health care costs in retirement suggests that the pressure for Medicare to cover a greater share of these costs will grow over time. If projected Medicare growth rates are “unsustainable,” what are the options for maintaining current benefit levels?

SPEAKERS

Dallas Salisbury, president and chief executive officer of the Employee Benefit Research Institute (EBRI), will provide an overview of current trends in employer-sponsored retiree health benefits, illustrate savings needs in retirement using the EBRI retiree health savings model, and discuss options for increasing savings for health care needs in retirement. Mr. Salisbury has written extensively on economic security topics, including 23 books, and participated on numerous commissions and study panels dealing with economics and retirement. These include the Secretary of Labor’s ERISA Advisory Council, the PBGC Advisory Committee, and the U.S. Advisory Panel on Medicare Education. He currently serves on the Advisory Committee to the Comptroller General of the United States and on the GAO Advisory Group on Social Security and Retirement.

Drawing on personal experience, journalist and author Stan Hinden will discuss the reality of coping with health expenses in retirement. After
retiring from *The Washington Post* in 1996, Mr. Hinden wrote the “Retirement Journal” column, which appeared in the Sunday business section of the Post from 1997 to 2004. He is also the author of the book *How to Retire Happy*, now in its second edition. During his 23-year career at the *Post*, Mr. Hinden wrote about stocks and mutual funds for 12 years. Prior to joining the *Post*, Mr. Hinden was the editor of *National Journal*.

ENDNOTES


8. Fidelity Investments, “Fidelity Investments Reports Boomers Turning 60 This Year Surpassed the $100,000 Mark in Average 401(K) Account Balance,” News Release, January 25, 2006; available at [http://content.members.fidelity.com/Inside_Fidelity/fullStory/1_650600.html](http://content.members.fidelity.com/Inside_Fidelity/fullStory/1_650600.html).


