What Advisors Need to Know about Health-Care Planning

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June 18, 2013

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Many people assume that once they retire, they need not worry about healthcare. They think Medicare is free and will take care of all their health-care needs.

That's not true.

Those who have cared for an ailing parent or a grandparent know the financial and lifestyle implications healthcare has for themselves and their loved ones. Consumer awareness is definitely lacking in this area. Many seniors need to know that every year, they can and should decide on different health-care options based on their changing needs.

Additionally, some people may think they can part with a good chunk of their assets to qualify for Medicaid. But the rules for Medicaid eligibility are becoming more and more stringent. In fact, Medicaid requires a five-year look-back on gifts of assets.

Health-care costs and coverage will continue to be the focus of our national debate. According to the White House Budget Office, the federal government collected about $2.5 trillion in revenue and spent over $900 billion in healthcare in the fiscal year 2012, which was more than one-third of all tax receipts. Medicare alone costs $545 billion, while Medicaid costs about $250 billion. Despite this spending, seniors continue to incur hundreds of thousand of dollars in out-of-pocket health-care expenses during retirement. With the cost of healthcare rising and longevity increasing, these issues will not disappear for the foreseeable future.

Guiding clients through the maze of the health-care choices retirees face is a way advisors can provide meaningful value. Here's an overview of the Medicare and Medicaid programs to help advisors understand the key economic considerations that will impact their clients.

Financial planning

In order to develop a reasonable retirement income plan and protect a client's estate-planning goals, one must anticipate health-care expenses. Financial planning is all about planning for unknowns: market rates of return, life expectancy and rate of inflation. We

create financial plans to manage these unknowns, and health-care expense planning is no different.

A recent survey conducted by Harris Interactive for Nationwide Financial revealed that nearly half of high-net-worth Americans who are close to retirement are "terrified" of what health-care costs could do to their retirement plans. But 38% of those surveyed said that they haven't discussed retirement health-care costs with a financial advisor, in part because they are unsure as to whether their advisor is knowledgeable about the issue. This is not a good sign.

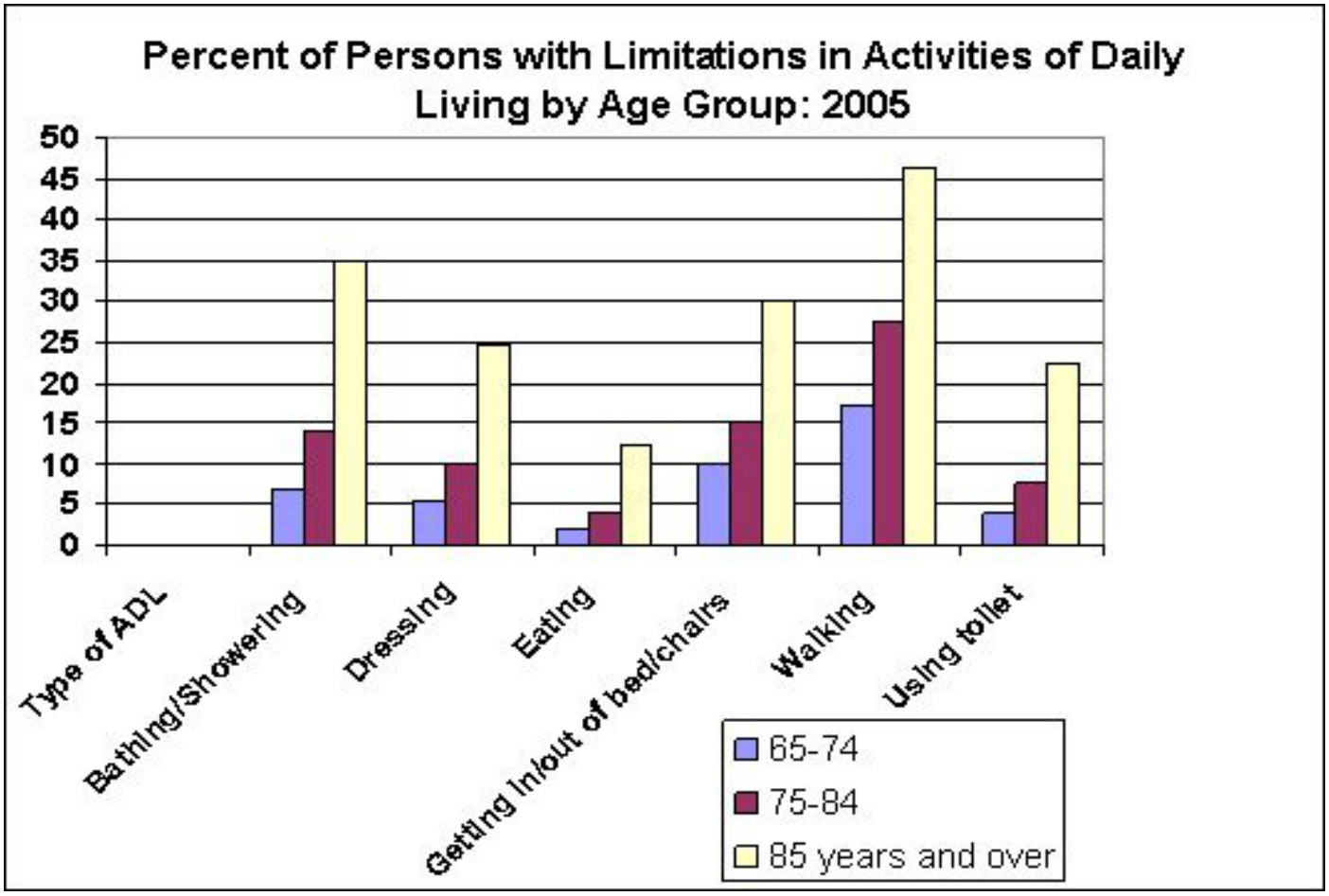
Health trends

Let's briefly delve into some of underlying trends affecting the health of seniors. According to the Alzheimer's Association, more than 5.2 million seniors (about one in eight elderly people) suffer from Alzheimer's, a number that could triple by 2050. Alzheimer's is only one of several leading causes of death. Other diseases, according to Centers for Disease Control (CDC), include cardiovascular disease, cancer, chronic respiratory disease and stroke. These all involve lengthy treatments and care.

The Center for Medicare and Medicaid Services says 64% of seniors struggle with three or more activities of daily life (ADLs), such as bathing, dressing, eating, getting in and out of bed or chairs, walking or using a toilet. It is not just the increase in the number of people suffering from diseases that is affecting the health-care system. People are also living a lot longer. According to the Social Security Administration, a man reaching age 65 today can expect to live, on average, for 18 more years until age 83. A woman turning age 65 today can expect to live, on average, until age 85. In 1940, the life expectancy for a man at age 65 was 78. That five-year increase doesn't necessarily mean five healthy years. About 44% of people reaching age 65 are expected to enter a nursing home at least once in their lifetimes. Of that 44%, about 53% will stay for one year or more in a nursing home[1]. The Department of Health and Human Services estimates 10% of the people who enter nursing homes will stay there five years or more. According to the American Association of Retired Persons, the lifetime probability of becoming disabled in at least two ADLs or being cognitively impaired is 68% for people aged 65 and older. Among seniors, 34% have difficulties with three or more ADLs.[2]

[1] Stillman and Lubitz, "Medical Care" 40 (10): 965-967

[2] Center for Medicare & Medicaid Services



How are people coping with these challenges? A small number are self-insured and can afford expensive treatments and care. Those who have some form of long-term care insurance are able to have some or all of the cost reimbursed. According to the American Long Term Care Insurance Association, the long-term care insurance industry paid about $6.6 billion in benefits in 2012. Some 264,000 individuals were receiving long-term care insurance benefit payments as of Dec. 31, 2012. But this is a small fraction of those receiving care. In 2011, more than 15 million family members and friends provided more than 17 billion hours of unpaid care that amounted to several hundred billion dollars of lost personal income.

"Having been in financial planning for 31 years, I have seen clients run out of money because of longevity and poor planning," says Idaho-based financial advisor Cheri Pinkerton CFP® with The H Group Inc. "In one case, a couple insisted they would not live past their 70s, even though they had a history of longevity in both families. They wanted to enjoy their money and not leave it to the kids. They are currently in their 90s and have spent all their money except for the Social Security they receive each month. She has

serious dementia and he's in poor physical health. Now one of their sons has been forced to move in with them as their caregiver in addition to working full time."

Continuing-care retirement communities (CCRC) are emerging as an alternative to home healthcare and private nursing care. CCRCs offer a tiered approach to the aging process, accommodating residents' changing needs. Upon entering, healthy adults can reside independently in single-family homes, apartments or condominiums. When assistance with everyday activities becomes necessary, they can move into assisted living or nursing care facilities.

CCRCs aren't cheap. They require a hefty entrance fee that can range from $100,000 to $1 million and ongoing monthly charges of several thousand dollars.

Health-care costs

Healthcare is the single biggest expense during retirement, and costs can vary considerably. According to John Hancock cost of care survey,the average cost of a private nursing home in Boston in 2011 was $124,830, compared to $63,875 in Phoenix, AZ. The cost for doctor visits and hospitalization also varies.

As a result, a single estimate of health-care expenses is irrelevant. While developing a client's retirement income plan, an advisor needs to carefully analyze a client's lifestyle, current health and family health history to estimate health-care expenses during retirement. An advisor doesn't need to be a doctor to run this analysis. With a basic understanding of Medicare and a software program, an advisor can get reasonable health-care cost estimates. This analysis would also be helpful to advisors who help their clients decide on the type and amount of coverage for long-term care insurance or other insurance products.

Medicare programs

Since Medicare is at the heart of healthcare for seniors, let's summarize its offerings:

- PART A, also known as the hospital insurance program, covers inpatient hospital services, skilled nursing facility, home health and hospice care. Part A is funded by a tax of 2.9% of earnings paid by employers and workers (1.45% each). Most beneficiaries do not pay a monthly premium for Part A services, but they are subject to a deductible and coinsurance.

- PART B, the supplementary medical insurance program, helps pay for physician, outpatient, home health and preventive services. Part B is funded by general revenues and beneficiary premiums (around $100 per month). Beneficiaries who

have higher annual incomes pay a higher, income-related monthly Part B premium. Part B also has a deductible and coinsurance of 20%.

- PART C, also known as the Medicare Advantage program, allows beneficiaries to enroll in a private plan, such as a health-maintenance organization, preferred-provider organization or private fee-for-service plan as an alternative to the traditional fee-for-service program. These plans receive payments from Medicare to provide Medicare-covered benefits, including hospital and physician services and, in most cases, prescription drug benefits.

- PART D, the outpatient prescription drug benefit, is delivered through private plans that contract with Medicare. These are either stand-alone prescription drug plans or Medicare Advantage prescription drug plans. Individuals who sign up for a Part D plan generally pay a monthly premium. Those with modest income and assets are eligible for assistance with premia and cost-sharing amounts.

While the cost of prescription drugs may not change from one place to another, some drugs are very expensive. For example, Soliris (which treats a rare disorder in which the immune system destroys red blood cells at night) costs $409,500 a year. Drugs for more common diseases, such as Provenge for prostate cancer and Lemtrada for multiple sclerosis, range between $20,000 and $100,000 for a one-year supply. The bulk of the prescription drug costs will be paid by Medicare if a person has Medicare Part D or prescription drug coverage. But one needs to plan for Part D insurance, deductible and copayment costs. Additionally, despite the implementation of the Affordable Care Act, once patients reach the annual limit of $2,800, they hit the coverage gap referred to as the "donut hole." They are then responsible for the full cost of their drugs until the total spending on drugs reaches the yearly out-of-pocket spending limit of $4,550 (for 2013). After this yearly spending limit, they are only responsible for about 5% of the cost of their drugs.

Medigap policies – also called Medicare supplement insurance – are sold by private insurance companies. They help cover Medicare's cost-sharing requirements and fill gaps with their coinsurance, copayments and deductibles for Medicare-covered services. Based on coverage options, there are 14 Medigap policy types (A through N) to choose from. The cost of a Medigap policy varies by state and plan type.

There are still some uncertainties around the Medicare program. In the long term, several factors – including rising health-care costs, an aging population, a decline in the number of workers per beneficiary and increasing life expectancy – will present fiscal challenges for Medicare. From 2010 to 2030, the number of people on Medicare is projected to rise from 47 million to 79 million, while the ratio of workers per beneficiary is expected to decline from 3.7 to 2.4. Total Medicare spending is projected to more than double from $545 billion

in 2012 to $1.038 billion in 2020, according to the Congressional Budget Office. For many people, long-term care cost will be their biggest health-care expense during retirement. These costs will continue to be an issue for most Americans regardless of the fate of Medicare.

Affordable Care Act

Making Medicare affordable and sustainable was one of the goals of the 2010 health-care law, also known as the Patient Protection and Affordable Care Act and commonly referred to as Obamacare. Without going into the details of this law, let's look at some of its provisions as they relate to the Medicare program.

Many provisions of this law will be implemented in phases over several years. For example,

- In 2010, it provided a $250 rebate for beneficiaries who reach the Part D coverage gap.
- In 2011, it began phasing in federal subsidies for generic drugs in the Medicare Part D coverage gap (reducing coinsurance from 100% in 2010 to 25% by 2020) and thus gradually filling the donut hole.
- Beginning 2012, it reduced rebates for Medicare Advantage plans.
- Starting 2013, Part D enrollees continue to receive a 52.5% discount on the total cost of their brand-name drugs while in the donut hole. The 50% discount is paid by the brand-name drug manufacturer and 2.5% is paid by the Medicare Part D plan. Enrollees pay a maximum of 79% co-pay on generic drugs while in the coverage gap.

Despite acrimonious political debate around Medicare, Medicaid and other health-care programs, there is a growing sentiment toward making government health-care programs means-tested. Even now, certain Medicare payments are based on a person's income level. But in the future, the scope of means testing is likely to broaden and will impact the cost of long-term care. A long stay in a private nursing home could severely affect financial and estate planning for high-net-worth individuals. Therefore, financial advisors must educate their clients about potential health-care expenses during retirement.

Opportunities for financial advisors

Planning for a major expense like healthcare during retirement is not only the right thing to do, but it is also an opportunity for financial advisors to earn the loyalty of their clients. It is not a difficult process. You need to understand the issues and the health-care system. If you have read this far, you have already accomplished this to a large extent. Second, you need to educate your clients who are nearing retirement, which will be challenging. If you

haven't talked to them in past about this topic, you don't want to give them a sticker shock. Using software as a tool to estimate a client's health-care expenses will make incorporating them in your client's retirement plan easier. Finally, keep this information up to date as a client's health or financial situation changes.

"The first thing you must to do to prepare your baby boomer and older clients for health-care expenses during retirement is to be willing to discuss it," said Brian Power, CFP®, principal at New Jersey-based Gateway Advisory. "I find a lot of financial advisors are not willing to go down the path of discussing retiree health-care expenses because they themselves do not know enough about the government retiree programs, and they hope that the conversation doesn't come up. The right approach is to understand Medicare, long-term care options and the future of health insurance in our country."

Health-care expenses are a baby-boomer's biggest challenge in retirement and advisors should employ health-care cost analysis to better engage clients as well as prospects.

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