

Financial Planning with Health Insurance in Mind

How much might health care cost you someday?

“Financially speaking, what would be the worst thing that could happen to you?” If you ask a hundred people in their forties that question, you may get a dozen different answers. Some may say “my business going under” or “losing my house.” Some might say “a divorce,” “a lawsuit,” or “being laid off.” But how many would say “a severe illness?”

A catastrophic illness seems like a remote possibility to many; distant, decades away. As a result, that possibility may be overlooked in our financial planning.

The healthiest of us may need to save the most for health care. This may seem paradoxical, but think about what many people in their eighties or nineties experience: years of declining health and mobility, and accompanying high health care expenses.

Two projections of average retirement health care costs are very illuminating in this regard. Empower Institute (an offshoot of retirement plan administration firm Great-West Financial) has calculated the amount of money that 65-year-old males with particular medical conditions will need in order to absorb 90% or more of future health care expenses. A 65-year-old man with Type 2 diabetes, for example, will need \$88,300 (in today’s dollars) to cope with those costs, according to Empower’s projection. It also estimates that a 65-year-old tobacco user will require \$114,900 and a healthy, non-smoking 65-year-old male, \$143,800.¹

Why the difference? According to the Empower forecast, the 65-year-old diabetic has a life expectancy of 78, versus 81 for the tobacco user, and 87 for his healthier counterpart.¹

How about a healthy 65-year-old woman? Empower projects she will need a retirement health care fund of \$156,000, as women currently outlive men on average.¹

Another take on all this comes from the respected Employee Benefit Research Institute. EBRI estimates that the average healthy 65-year-old today will need \$124,000 to handle future medical expenses. EBRI’s director of health research, Paul Fronstin, told the *Wall Street Journal* that a pre-retiree should adjust that number for inflation as follows: increase it by 5% for each year remaining until your planned retirement date. So if you are 50 right now, you will need about \$250,000 to cover medical costs if you retire in 2031.¹

The more you earn, the more you may pay for essential health benefits. Take the case of Medicare premiums. Most Medicare beneficiaries who are single filers with modified adjusted gross incomes of \$85,000 or less are paying monthly Part B premiums of \$104.90-\$121.80 this year. In contrast, single filers with MAGIs between \$85,001-107,000 are paying Part B premiums of \$170.50 a month. That premium jumps to \$243.60 for a single filer with MAGI greater than \$107,000, and extremely high-earning individuals pay more than that. Pre-retirees

should be mindful of this, and the fact that Medicare does not pay for long term care or dental care.^{2,3}

Your income level may also affect how much you pay for health coverage before you retire. As an example, a Texas household of four that expects its 2016 income to be between \$24,300 and \$60,625 can go to the Health Insurance Marketplace and qualify for health plans with relatively low premiums, plus savings on deductibles and copayments. A similarly sized Texas household with income higher than \$97,000 cannot qualify for any such savings and must pay full price for their health coverage at the Marketplace.⁴

So looking ahead, is a Health Savings Account a good idea? For the future, it may be. HSAs must be used in conjunction with high-deductible health plans, but even with that requirement, these accounts can give pre-retirees a nice, dedicated savings vehicle to plan for future health care expenses. An HSA may become an important part of a long-run financial strategy.⁵

The annual contribution limit on an HSA is currently \$3,350 for individuals, \$6,750 for families. Contributions are 100% tax-deductible. (You can even make \$1,000 catch-up contributions beginning in the year you turn 55, as long as you are not a Medicare recipient.) You can also optionally invest the money within the account. An HSA is tax-advantaged: assets get tax-free growth, and withdrawals are tax-free if you use the money to pay for qualified health expenses. HSAs also have another nice feature: once you turn 65, you may use withdrawals from them for non-medical purposes, though such withdrawals will be taxable. If you enroll in Medicare, you can no longer contribute to an HSA – so it is vital to fund these accounts for some years before retiring.^{5,6}

It is only prudent to factor potential health care costs into your financial plan. Some healthy pre-retirees may assume that they will need only a five-figure rather than six-figure sum to address them. That assumption may be flawed.

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Citations.

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2 - medicare.gov/what-medicare-covers/not-covered/item-and-services-not-covered-by-part-a-and-b.html [3/10/16]

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