Understanding Health Insurance Options in Retirement

A White Paper by Manning & Napier

www.manning-napier.com
Over the past several years, the spike in the cost of health care and insurance premiums has been alarming. Many employed individuals have had at least a portion of these increases covered by their employers. However, once retired, a meaningful portion of the cost may have to be borne by retirees themselves. This paper is intended to provide a backdrop of the current health insurance landscape for retirees. Specifically, this paper gives a broad overview of the Medicare system and provides retirees with information which may help them understand their health insurance options in retirement. Furthermore, this paper includes information on the magnitude of potential health care-related costs throughout retirement. Additional information on Medicare and other retirement health care options can be found on the Medicare website (www.medicare.gov).

**Rising Health Care Costs**

Several studies are completed each year concerning the potential costs of health care borne by individuals during retirement. Some of the most commonly discussed statistics revolve around the general increase in health care costs, the dollar amount that retirees may need to spend on health care during retirement, and current working individuals' ability to save for such costs. While many studies exist, a commonly cited study which provides an array of statistics is completed by the Employee Benefit Research Institute (EBRI). A substantial portion of this study looks at the initial savings that a retiring couple may need in order to fund medical expenses throughout retirement (Medicare Part B and D premiums, Medigap insurance, and out-of-pocket drug costs, but excluding nursing home care). The study separates the results based on simulations involving longevity, investment return, and medical costs, as well as on alternative (average and high) prescription drug expense levels. The chart on the right shows the total savings needed at retirement to fund these expenses for the average couple (i.e., having median prescription drug expenses) and for the couple expecting to be affected by longer life, lower investment returns, and/or higher medical expenses (i.e., 90th percentile of prescription drug expenses). It also shows the savings needed for each of these couples to have a 50% chance and a 90% chance of meeting their total health care expenses.

### Savings Needed for Medicare Part B and Part D Premiums, Medigap Premiums, and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2013

<table>
<thead>
<tr>
<th>Chance of Savings Meeting Total Expenses</th>
<th>Median Prescription Drug Expenses Throughout Retirement</th>
<th>90th Percentile of Prescription Drug Expenses Throughout Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>50%</td>
<td>$151,000</td>
<td>$220,000</td>
</tr>
<tr>
<td>90%</td>
<td>$255,000</td>
<td>$360,000</td>
</tr>
</tbody>
</table>

Source: Employee Benefit Research Institute.

In addition to looking at the current amount that an individual may need to save for retirement health care costs, it is important to understand how significantly this figure has increased over the years. As EBRI reports, growth in Medicare costs outpaced the rate of GDP growth by 2.5% per year from 1975-2008. The increase in Medicare Part B premiums in particular has been even greater of late, as Medicare Part B premiums increased by 10% per year on average from 2003 through 2008, and by over 14% in 2010.

**Medicare**

Medicare is a government-run health insurance system for elderly and disabled Americans. The system is funded through employee and employer payroll contributions during working years, and covers a portion of health care costs primarily for individuals age 65 and over. Medicare is split into four separate segments, called Medicare Parts A, B, C, and D. Each segment of Medicare covers different portions of the potential health care costs that retirees may face.
Medicare Part A

Medicare Part A (Part A) is a hospital insurance program that is offered to all individuals who have paid Medicare taxes for at least ten years (40 work quarters). If a retiree is already receiving Social Security benefits before turning 65, they will automatically be enrolled in Part A benefits at age 65. Other individuals will need to contact Social Security when they are approaching age 65 to apply for Part A coverage. Medicare eligibility begins on the first day of the month in which an individual reaches age 65, and individuals are advised to contact Social Security three months prior to that date.

Part A generally covers a majority of the costs associated with hospitalization. An overview of specific items covered by Part A is below. However, the items below may have deductibles, co-payments, and/or co-insurance, which are not covered by Part A, associated with them.

Home Health Services
Part A covers home health services (medical care) for individuals who are unable to leave their homes without assistance. This differs from custodial care, which assists individuals who can not complete common daily living activities (such as bathing), but does not provide medical coverage.

Hospice Care
For terminally ill patients (i.e., patients expected to live less than six months), Part A provides hospice care, including drugs, medical, and social services.

Inpatient Hospital Treatment
Part A covers inpatient hospital stays, including a semi-private room, food, and drugs administered while in the hospital. Private nursing care, televisions, or other personalized items are typically not covered by Part A.

Skilled Nursing Care
Skilled nursing care after an inpatient hospital stay of at least three days is covered by Part A. Covered services include semi-private rooms, food, skilled nursing, rehabilitative services, and physical therapy.

Blood
If the hospital receives blood from a blood bank, or if the blood is donated by a friend or a relative, then the cost of blood is covered. Beyond that, individuals must pay for the first three units of blood that they receive in a given year, and Part A covers everything above that.

Medicare Part B

While Part A generally covers costs associated with hospitalization, Medicare Part B (Part B) covers many of the costs associated with doctors’ services, use of medical equipment, ambulance fees (when medically necessary), outpatient physical therapy, some blood work, and preventive care (e.g., diabetes tests, flu shots, cancer screenings, etc.), as well as other similar costs. These costs are generally covered at a coinsurance percentage after an individual satisfies the annual Part B deductible ($147 in 2014). Unlike Part A coverage, which is free for most retirees, Part B coverage is optional and requires the payment of a premium for retirees to receive benefits. The cost of Part B varies widely, depending on Modified Adjusted Gross Income. For retirees who have Modified Adjusted Gross Income of $85,000 or less for individuals, or $170,000 or less for married couples filing a joint tax return, the cost of Part B is $104.90/month in 2014. Retirees who have Modified Adjusted Gross Income above these levels will have a higher Part B premium, which is outlined below.

2014 Monthly Medicare Part B Premiums

<table>
<thead>
<tr>
<th>Modified Adjusted Gross Income (in 2012)</th>
<th>Medicare Part B Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Files an Individual Tax Return</td>
<td>Files a Joint Tax Return</td>
</tr>
<tr>
<td>$0 - $85,000</td>
<td>$0 - $170,000</td>
</tr>
<tr>
<td>$85,001 - $107,000</td>
<td>$170,001 - $214,000</td>
</tr>
<tr>
<td>$107,001 - $160,000</td>
<td>$214,001 - $320,000</td>
</tr>
<tr>
<td>$160,001 - $214,000</td>
<td>$320,001 - $428,000</td>
</tr>
<tr>
<td>Above $214,000</td>
<td>Above $428,000</td>
</tr>
</tbody>
</table>

Once retired individuals begin receiving Part A benefits, they are automatically enrolled in Part B and must waive the benefits if they do not want them. Individuals should be aware that they generally have only a seven month window to sign up for Part B at the stated costs (counting the month they reach age 65, plus the three month periods preceding and following that month). Retirees who enroll outside of this window will have to wait for a general Part B enrollment period (January 1 - March 31 of each year, with coverage becoming effective July 1 of the same year). They may also have to pay a late enrollment penalty which will cause their premium to be higher for as long as they remain covered under Part B. The delay in enrollment and the late enrollment penalty do not apply to individuals who continue to work past age 65 and who are covered under an employer’s health plan. These individuals will have a special enrollment period for eight months after the earlier of the date their employment or employer coverage ends.

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Medicare Part C

Medicare Part C (Part C), also known as Medicare Advantage, is another way to get the benefits and services covered under Parts A and B. Part C plans are approved by Medicare but are run through private insurance companies that have contracts with Medicare to provide coverage. In general, when signing up for Medicare at age 65, retirees are given the option of electing Part A (as well as potentially adding on Part B and/or Medigap insurance), or selecting Part C. If retirees would like to elect Medicare Part C coverage, they must also enroll in both Parts A and B. Part C policies vary drastically and can include vision, dental, and some prescription drug coverage.

Part C plans are set up in several different ways. For example, Part C coverage can be run through an HMO or a PPO. Thus, for expenses to be covered, retirees may need to see only certain physicians (i.e., in-network providers). Likewise, since the insurance is run through private insurers, coverage provisions and premiums can vary widely.

There are several places to find more information on Part C plans. One of the most comprehensive websites is the government’s Medicare website (www.medicare.gov). The Medicare website allows individuals to enter information about their area of residence, the level of coverage they are seeking, their current prescription drugs, and other pertinent information. Then, they will receive an output of all the local plans that may fit their situation, along with the approximate pricing of the plans. This website allows individuals to compare plans side-by-side and includes a vast amount of information, such as plan ratings, coverage areas, and much more.

Medicare Part D

Medicare Part D (Part D) provides prescription drug coverage, and in order to sign up for Part D, retirees must be enrolled in either Part A or Part B. Enrollment into a Part D plan may be deferred with no penalty for individuals who are covered under another health care plan with creditable prescription drug coverage. (Prescription drug coverage is creditable if it is expected to pay, on average, at least as much as Part D standard coverage would pay.) Individuals who have Medicare Advantage policies may not need Part D, since many Medicare Advantage plans offer at least some prescription drug coverage (however, retirees should determine if their specific plan is sufficient). Like Part C, Part D coverage is provided through private insurers who have contracts with Medicare, and while each plan may have slightly different premiums and cover different classes of drugs, the basics of each plan are standardized. Before selecting a plan, retirees should closely examine each plan’s drug formulary and pharmacy network to ensure they select a plan that will cover their necessary prescription medications and will have adequate pharmacy access to meet their needs.

In general, each Part D plan will have a monthly premium (based on your income), while many plans will have a small annual deductible. Once the deductible is reached, each plan will pay for some or all costs until total costs (counting the deductible and the amounts paid by both the plan and the retiree) reach $2,850. Then, for all plans, all drug costs above $2,850 in a given year will generally be paid for by the retiree until the retiree’s out-of-pocket costs reach $4,550. These costs are commonly referred to as the “donut hole” of Part D, as coverage does not exist within this window. However, with the passing of the Health Care and Education Reconciliation Act of 2010, the “donut hole” will be phased out over time until it is completely eliminated in 2020. This law will also help to mitigate prescription drug costs before the “donut hole” is eliminated, as low- and middle-income retirees will get a 52.5% discount on covered brand name prescription drugs and a 28% discount on generic prescription drugs in 2014 (these discounts paid by drug companies count toward the retirees’ out-of-pocket limit). Finally, Part D plans will generally cover a majority of prescription drug costs above the $4,550 out-of-pocket costs, with retirees paying only a small coinsurance or copayment. The cost figures shown for Part D (i.e., $2,850 and $4,550) are for 2014.
Medigap Policies
As the previous pages have highlighted, while Medicare Parts A-D cover different portions of health care costs in retirement, their coverage is incomplete. Specifically, the policies have a large number of gaps, including potentially large co-insurance burdens and deductibles. As such, Medicare has created ten policies that cover these gaps, known as Medigap policies. These policies, which are standardized by Medicare but are run through private insurance companies, are intended to provide retirees with optional additional coverage during retirement. Retirees must be enrolled in both Part A and Part B in order to be covered by a Medigap policy.

Medigap policies can have three types of cost structures which are all based on age and area of residence. Thus, private insurers cannot charge less healthy individuals a higher premium if they sign up within a six month window starting at age 65. In contrast, if a retiree does not sign up for Medigap during their six month open enrollment period, they may still be able to get coverage, but they will be subject to the insurance company’s medical underwriting guidelines, meaning that the costs may be higher or they may be denied coverage. The chart on page 8 highlights the characteristics of the ten standardized Medigap policies.

Determining the Appropriate Plan
Retirees have several important decisions to make once they reach age 65. Specifically, if a retiree enrolls in Medicare Part A, should they sign up for Medicare Part B? What about Part D (drug coverage) and one of several Medigap policies? If they instead enroll in a Medicare Part C plan through a private insurer, which policy is most appropriate? Unfortunately, there is no single answer that helps determine which health insurance option in retirement is the most appropriate. However, there are a few key determining factors to consider, which are outlined in the flow chart on page 9, and discussed below.

Open Network
In general, many physicians will accept Medicare coverage, including Medicare Parts A and B, and Medigap policies. However, with a Medicare Advantage Plan (Part C), retirees may need to stay within a particular network of doctors. This may involve changing doctors or using doctors with whom the retiree is less comfortable.

Copayments and Deductibles
With a Medigap policy, a retiree may have much lower deductibles and copayments, since the policy is intended to reduce these. In contrast, a Medicare Advantage policy may result in higher out-of-pocket costs for service (this is highly dependent on each policy).

Premiums
Many factors will affect premiums, including location and coverage provisions. In order to determine which option is most appropriate, retirees should get quotes in their area from insurers as they near age 65. Getting quotes from multiple insurers is recommended since prices may vary widely. Retirees will need to carefully review and compare coverage and costs between original Medicare (Parts A and B) plus Part D and Medigap, with the costs and coverage available under Medicare Advantage plans in their area in order to select the best option for their individual situations.

Drug Coverage
A key difference between different plans is the level of drug coverage provided. Some Medicare Part C (Medicare Advantage) plans provide drug coverage, including different levels of drug coverage, while others do not.

Medigap Timing
Medigap policies must be bought within six months of signing up for Medicare Part B coverage. If the deadline is missed, retirees risk disqualification and/or higher premiums.
Meeting Health Care Costs Before Age 65
Some employers allow qualified retirees to continue employer group coverage at subsidized rates. When provided by former employers, the coverage can be fairly comprehensive, especially given the subsidized pricing structure. However, the number of companies offering these benefits has declined over time.

There are alternatives for retirees that are not offered continued health care benefits by their employer (or by their spouse's employer). First, there is COBRA, which includes a Federal law that requires employers with 20 or more employees to offer continued coverage for the first 18 months after individuals leave the employer. Some states allow for longer periods of continued coverage, and some states also have similar coverage continuation requirements for employers with fewer than 20 employees. While COBRA offers continued coverage at group rates, the retiree bears the full cost of coverage, plus a 2% administration fee. On average, this amounts to costs of approximately $500/month for individuals and $1,390/month for families. Employers are required to provide the same group coverage offered to active employees, regardless of current medical condition.

Another option for some early retirees is to join a group plan through a trade group, such as AAA, AARP, or a similar organization. These plans will typically provide insurance coverage at a rate that may be lower than for an individual plan through a private insurer. However, depending on the group that is offering the plan, the terms of the plan, and other specifics, access to and coverage within many of these plans may be limited. As such, it is recommended that different plans are compared side-by-side before a decision is made.

Individuals who do not have access to a group plan and retire before age 63½ (i.e., resulting in a gap between COBRA coverage and Medicare) may be required to purchase private health insurance. Coverage is not guaranteed and prices may fluctuate substantially so it is again beneficial to get multiple quotes. If insurance is offered, it is typically at a higher rate than that under COBRA (since COBRA is priced based on the previous employer’s group rate, not an individual’s rate).

Beginning in 2014, coverage is also available to individuals through the health care exchanges established under the Affordable Care Act. Coverage options and pricing will vary by geographic area. More information on coverage options is your state is available through the Federal Health Insurance Marketplace (www.healthcare.gov).

Working Beyond Age 65
Your options, if you continue to work beyond age 65, vary based on the number of employees working at your company.

If your company has fewer than 20 employees, Medicare will be your primary plan and your employer plan will be secondary. You will need to enroll in both Medicare Part A and Part B in order for your employer plan’s coverage to continue.

If your company has 20 or more employees, your employer plan will be primary and Medicare will be secondary. You may delay enrollment in Part B without penalty as long as you continue to work and maintain coverage in your employer plan. You will be eligible for a Medicare Part B Special Enrollment Period for eight months after you stop working or your employment-based coverage ends, whichever occurs first. You may also delay enrollment in Part D without penalty, provided that the employer plan that covers you provides creditable prescription drug coverage. Contact your employer’s Human Resources Department for information on whether your plan provides creditable prescription drug coverage.

How Often Can Retirees Switch Coverage
The Medicare system has an open enrollment period each year. In 2013, the enrollment period was scheduled from October 15, 2013 – December 7, 2013 to select coverage for 2014. During open enrollment, retirees determine if they’d like to select Medicare Parts A, B, C, and/or D, as well as Medigap coverage. Retirees typically can’t switch their coverage outside of the open enrollment period, although there are exceptions (e.g., if the retiree moves outside of the plan’s service area). Also, retirees can switch to a Medicare Advantage Plan or Medicare Prescription Drug Plan that has a five-star rating at any time during the year. This five-star special enrollment period can only be used once per year. For more information about Medicare’s plan ratings, visit www.medicare.gov/publications to view the fact sheet, “Use Medicare’s Information on Quality to Help You Compare Plans.”
Conclusion
The alarming rate of health care cost inflation, as well as the evolving health care marketplace, has created dispersion between the costs of different health care options in retirement. As such, it is important for individuals to understand their options and to price out different plans as they near retirement. Those who retire before age 63½ should determine if their employer will allow them to continue coverage (or should consider other group health insurance options, if possible) before purchasing private health insurance. Coverage options can also be explored through the health care exchanges established under the Affordable Care Act. For those who have reached age 65, it is important to weigh the costs of various health care options offered through Medicare, through private insurance companies, and through your current/former employer. The Medicare website (www.medicare.gov) provides extensive information on a wide variety of retirement health care issues, and is a good reference source.
## The Ten Standardized Medigap Policies

### How to Read the Chart

If an X appears in this chart, the Medigap policy covers 100% of the described benefit. If a column lists a percentage, the Medigap policy covers that percentage of the described benefit. If a cell in a column is blank, the policy doesn't include that provision.

### You May Buy the Following Medigap Plans:

<table>
<thead>
<tr>
<th>Medigap Benefits</th>
<th>Medigap Plans Effective On or After June 1, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare Part A Co-insurance: hospital costs up to an additional 365 days after Medicare benefits are used up</td>
<td>X       X       X       X       X       X       X       X       X       X</td>
</tr>
<tr>
<td>Medicare Part B Co-insurance or Co-payment</td>
<td>X       X       X       X       X       X       50%     75%     X       X**</td>
</tr>
<tr>
<td>Blood (First 3 Pints)</td>
<td>X       X       X       X       X       X       50%     75%     X       X</td>
</tr>
<tr>
<td>Part A Hospice Care Co-insurance or Co-payment</td>
<td>X       X       X       X       X       X       50%     75%     X       X</td>
</tr>
<tr>
<td>Skilled Nursing Facility Care Co-insurance</td>
<td>X       X       X       X       X       X       50%     75%     X       X</td>
</tr>
<tr>
<td>Medicare Part A Deductible</td>
<td>X       X       X       X       X       X       50%     75%     50%     X</td>
</tr>
<tr>
<td>Medicare Part B Deductible</td>
<td>X       X       X       X       X       X       50%     75%     50%     X</td>
</tr>
<tr>
<td>Medicare Part B Excess Charges</td>
<td>X       X       X       X       X       X       50%     75%     50%     X</td>
</tr>
<tr>
<td>Foreign Travel Emergency (Up to Plan Limits)</td>
<td>X       X       X       X       X       X       50%     75%     50%     X</td>
</tr>
<tr>
<td>2014 Out-of-Pocket Limit**</td>
<td>$4,940  $2,470</td>
</tr>
</tbody>
</table>

*Plan F also offers a high-deductible plan. This means you must pay for Medicare-covered costs up to the deductible amount ($2,140 in 2014) before your Medigap plan pays anything.
**Plan N pays 100% of the Part B coinsurance, except for a copayment of up to $20 for some office visits and up to a $50 copayment for emergency room visits that don't result in an inpatient admission.
***After you meet your out-of-pocket yearly limit and your yearly Part B deductible ($147 in 2014), the Medigap plan pays 100% of covered services for the rest of the calendar year.

Note: The Medigap policy covers co-insurance only after you have paid the deductible (unless the Medigap policy also covers the deductible).

This chart was provided by the Medicare website (www.medicare.gov).
Medicare Coverage Options

Step 1: Decide how you want to get your coverage

ORIGINAL MEDICARE
Medicare provides this coverage directly
You have your choice of doctors, hospitals, and other providers that accept Medicare

| Part A Hospital Insurance | Part B Medical Insurance |

OR

MEDICARE ADVANTAGE PLAN (Part C)
(like an HMO or PPO)
Private insurance companies approved by Medicare provide this coverage
You may need to use the plan's network of doctors, hospitals, and other providers

Combines Part A, Part B, and usually Part D.
You must be enrolled in Part A AND Part B.

Step 2: Decide if you need to add prescription drug coverage

What will your specific prescription drugs cost under each plan?
Will you pay a penalty if you join a drug plan later?

Part D Prescription Drug Coverage.
You must be enrolled in Part A OR Part B.

Part D Prescription Drug Coverage
(If not already included).

If you join a Medicare Advantage Plan, you don’t need and can’t be sold a Medigap policy.

Step 3: Decide if you need to add supplemental coverage

Are you concerned about the ongoing deductibles and co-insurance costs, and would you want to have those costs covered by a Medigap policy?

Medigap Policy
(Medicare Supplemental Insurance).
You must be enrolled in Part A AND Part B.

Information provided by the Medicare website (www.medicare.gov).
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