

# Notes

## The Impact of Repealing PPACA on Savings Needed for Health Expenses for Persons Eligible for Medicare, p. 2

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### E X E C U T I V E   S U M M A R Y

#### **The Impact of Repealing PPACA on Savings Needed for Health Expenses for Persons Eligible for Medicare**

**THE “DONUT HOLE”:** In 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) added outpatient prescription drugs as an optional benefit. When the program was originally enacted, it included a controversial feature: a coverage gap, more commonly known as the “donut hole.” The Patient Protection and Affordable Care Act of 2010 (PPACA) included provisions to reduce this coverage gap.

**REPEALING PPACA:** This article examines the impact that repealing PPACA would have on savings targets for health care expenses in retirement. The estimates suggest that retirees with high levels of prescription drug use throughout retirement would see their savings targets increase roughly 30–40 percent were the coverage gap reduction in PPACA repealed. Individuals at the median (midpoint) level of prescription drug use throughout retirement would not see any change in savings targets.

# The Impact of Repealing PPACA on Savings Needed for Health Expenses for Persons Eligible for Medicare

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## Introduction

In 2003, 38 years after the introduction of Medicare, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) added outpatient prescription drugs as an optional benefit. Known as Medicare Part D, Medicare beneficiaries can voluntarily enroll in the program either through stand-alone Prescription Drug Plans or through Medicare Advantage Plans. In either case, enrollees are usually required to pay a monthly premium, and there are various levels of cost sharing.

When the Part D program was originally enacted, a controversial feature of the program was the coverage gap, or so-called “donut hole.” Part D enrollees paid the entire cost of their prescription drugs in the coverage gap. Starting in 2011, enrollees have a \$310 deductible, followed by 25 percent coinsurance on the next \$2,530 in expenses. Once enrollees incur \$2,840 in expenses, they are responsible for the entire cost of prescription drugs until the catastrophic threshold of \$4,550 is reached. An enrollee who reaches the catastrophic threshold would pay \$1,710 toward the cost of prescription drugs in the coverage gap. Once the catastrophic threshold is met, the enrollee is responsible for 5 percent coinsurance.

The Patient Protection and Affordable Care Act of 2010 (PPACA) included provisions to reduce the size of the coverage gap. In 2011, enrollees get a 50 percent discount on certain brand-name drugs and a 7 percent discount on generic drugs when in the coverage gap. By 2020, additional subsidies will be phased in so that enrollees will pay 25 percent of the cost of prescription drugs when in the coverage gap whether for generic or brand-name drugs.

Repeal of PPACA, as advocated by congressional Republicans, could mean a return to the coverage gap for Part D enrollees, increasing their out-of-pocket costs and the savings needed to cover their health care expenses in retirement. This article examines the impact that repealing PPACA would have on savings targets for health care expenses in retirement.

The estimates provided here suggest that retirees with high levels of prescription drug use throughout retirement would see their savings targets increase by roughly 30–40 percent were the coverage gap reduction in PPACA repealed. Individuals at the median level of prescription drug use throughout retirement would not see any change in savings targets.

## Modeling Technique

Determining how much money an individual or couple needs in retirement to cover health care expenses is a complicated process. The amount of money a person needs will depend on the age at which he or she retires; length of life after retirement; the availability of health insurance coverage after retirement to supplement Medicare and the source of that coverage; health status and out-of-pocket expenses; the rate at which health care costs will increase; and interest rates and other rates of return on investments. In addition, public policy that changes any of the above factors will also affect spending on health care in retirement. While it is possible to come up with a single number that individuals could use to set retirement savings goals, a single number based on averages would be wrong for the vast majority of the population.

This analysis uses a Monte Carlo simulation model<sup>1</sup> to estimate the amount of savings needed to cover health insurance premiums and out-of-pocket health care expenses in retirement. Estimates are presented for

persons who supplement Medicare with a combination of individual health insurance through Plan F Medigap coverage and Medicare Part D for outpatient prescription drug coverage. For each source of supplemental coverage, the model simulated 100,000 observations allowing for uncertainty related to individual mortality and rates of return on assets in retirement,<sup>2</sup> and it computed the present value of the savings needed to cover health insurance premiums and out-of-pocket expenses in retirement at age 65. These observations were used to determine asset targets for having adequate savings to cover retiree health costs 50 percent, 75 percent, and 90 percent of the time. Estimates are also jointly presented for a stylized couple both of whom are assumed to retire simultaneously at age 65.

## Impact of PPACA on Savings Targets

Figure 1 contains the savings estimates for a person who purchases Medigap Plan F and Medicare Part D outpatient drug benefits to supplement Medicare. As discussed above, there will be uncertainty related to a number of variables, such as health care costs, longevity, and interest rates. Among persons with Medicare Part D, there is also the uncertainty related to health status and prescription drug use. Projections of savings needed to cover out-of-pocket expenses for prescription drugs are highly dependent on the assumptions used for drug utilization. There are three sets of columns of estimates in Figure 1: one where prescription drug use is at the *median* throughout retirement, one where prescription drug use is *higher* (at the 75<sup>th</sup> percentile throughout retirement), and one where prescription drug use is *much higher* (at the 90<sup>th</sup> percentile throughout retirement). Under each set of columns, a comparison of the savings targets is presented assuming both that PPACA is unchanged and that it is repealed.

Chance of Having Enough Savings	Median Prescription Drug Expenses Throughout Retirement		75th Percentile of Prescription Drug Expenses Throughout Retirement		90th Percentile of Prescription Drug Expenses Throughout Retirement	
	PPACA Not Repealed	PPACA Repealed	PPACA Not Repealed	PPACA Repealed	PPACA Not Repealed	PPACA Repealed
<b>Men</b>						
50 percent	\$71,000	\$71,000	\$80,000	\$82,000	\$106,000	\$141,000
75 percent	107,000	107,000	120,000	123,000	154,000	213,000
90 percent	136,000	136,000	154,000	157,000	194,000	274,000
<b>Women</b>						
50 percent	95,000	95,000	107,000	109,000	138,000	190,000
75 percent	124,000	124,000	140,000	143,000	178,000	249,000
90 percent	156,000	156,000	176,000	180,000	221,000	315,000
<b>Married Couple</b>						
50 percent	166,000	166,000	187,000	191,000	244,000	331,000
75 percent	231,000	231,000	260,000	266,000	332,000	463,000
90 percent	287,000	287,000	323,000	330,000	407,000	577,000

Source: Author simulations based on Employee Benefit Research Institute assumptions described in the text.

Separate estimates are presented for men and women. Because women have longer life expectancies than men, they will generally need larger savings than men to cover health insurance premiums and health care expenses in retirement when examining needed savings, regardless of the savings target. In other words, women will need greater initial savings than men when both set a goal—for example, of having a 90 percent chance of having enough money to cover health expenses in retirement.

**Median Drug Expenses:** According to Figure 1, repeal of PPACA would have no impact on savings targets for men or women with median drug expenditures throughout retirement.

A man would need \$71,000 in savings and a woman would need \$95,000 if each has a goal of having a *50 percent* chance of having enough money saved to cover health care expenses in retirement. If either instead wanted a *90 percent* chance of having enough savings, a man would need \$136,000, and a woman would need \$156,000.

A couple both with median drug expenses would need \$166,000 to have a *50 percent* chance of having enough money to cover health care expenses in retirement. They would need \$231,000 to have a *75 percent* chance of covering their expenses, and \$287,000 to have a *90 percent* chance of covering their expenses.

**75<sup>th</sup> percentile in Drug Expenses:** Repealing PPACA would have a slight impact—2–3 percent—on the savings targets for individuals and couples with drug expenditures at the 75<sup>th</sup> percentile throughout retirement. Needed savings would be \$80,000 for a man under PPACA, and \$82,000 if PPACA were repealed and he wanted a *50 percent* chance of having enough savings to cover health care expenses in retirement. For a woman, the savings target would increase from \$107,000 to \$109,000 if PPACA were repealed and she wanted a *50 percent* chance of having enough. Even at the *90 percent* target, the difference would be about 2 percent. A man would need \$154,000 under PPACA and \$157,000 if PPACA were repealed, while a woman would need \$176,000 and \$180,000, respectively.

**90<sup>th</sup> percentile in Drug Expenses:** Individuals at the 90<sup>th</sup> percentile in drug spending at and throughout retirement would be most affected by repeal of PPACA as it relates to cost sharing in the coverage gap. Needed savings for a man would be \$106,000 under PPACA, and \$141,000—a difference of 33 percent—if PPACA were repealed and he wanted a *50 percent* chance of having enough savings to cover health care expenses in retirement. For a woman, the savings target would increase from \$138,000 to \$190,000—or 37 percent—at the *50 percent* target if PPACA were repealed. If instead each wanted a *90 percent* chance of having enough money in retirement to cover health insurance premiums and health care costs, the savings target for men would increase from \$194,000 to \$274,000 (up 41 percent), and the savings target for women would increase from \$221,000 to \$315,000 (up 43 percent).

## Conclusion

Individuals will be responsible for saving for health insurance premiums and out-of-pocket expenses in retirement for a number of reasons. Medicare generally covers only about two-thirds of the cost of health care services for Medicare beneficiaries age 65 and older, while out-of-pocket spending accounts for 14 percent (Fronstin, Salisbury, and VanDerhei, 2010). Furthermore, the percentage of private-sector establishments offering retiree health benefits fell from 11.3 percent in 1997 to 6.2 percent in 2009.<sup>3</sup> As a result, the eligibility rate for health benefits from a former employer in retirement has been declining.<sup>4</sup>

This article provides estimates for savings needed to cover health insurance to supplement Medicare and out-of-pocket expenses for health care services in retirement. PPACA reduced cost sharing in the Part D coverage gap, or so-called “donut hole,” but if repeal of PPACA eliminates this provision, beneficiaries will need to increase their targeted savings level to account for additional out-of-pocket spending. It was found that retirees with high outpatient drug use would be most affected by repeal and would need to save an additional roughly 30–40 percent to make up the shortfall.

Many individuals will need more money than the amounts cited in this analysis because it does not factor in the savings needed to cover long-term care expenses,<sup>5</sup> nor does it take into account the fact that many

individuals retire prior to becoming eligible for Medicare. However, some workers will need to save less than what is reported if they choose to work during retirement and receive health benefits as active workers.

Finally, issues surrounding retirement income security are certain to become an even greater challenge in the future as employers continue to scale back retiree health benefits, and when policymakers begin to realistically address financial shortfalls in the Medicare program with solutions that are likely to shift more responsibility for health care costs to Medicare beneficiaries.

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## Endnotes

<sup>1</sup> A technique used to estimate the likely range of outcomes from a complex process by simulating the process under randomly selected conditions a large number of times.

<sup>2</sup> Nominal after-tax rates of return were assumed to follow a log-normal distribution with a mean of 1.078 and a standard deviation of 0.101. This provides a median nominal annual return of 7.32 percent.

<sup>3</sup> See [www.ebri.org/pdf/FFE182.26Oct10.EarlyRets.Final.pdf](http://www.ebri.org/pdf/FFE182.26Oct10.EarlyRets.Final.pdf)

<sup>4</sup> In 1988, only about one-third of workers ages 46–64 reported that they would be eligible for employment-based health benefits to supplement Medicare upon retirement (Fronstin, 1996). However, by 2005, only about 23 percent of Medicare beneficiaries had retiree health benefits through a former employer as a supplement to Medicare (Fronstin, Salisbury, and VanDerhei, 2008).

<sup>5</sup> See VanDerhei (2006) for estimates of the impact of long-term care expenses on the amounts needed for sufficient retirement income at the 50<sup>th</sup>, 75<sup>th</sup>, and 90<sup>th</sup> percentiles.



# Notes

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