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Notes

Amount of Savings Needed for Health Expenses for People Eligible for Medicare: Good News Not So Rare Anymore, p. 2

AT A GLANCE

Amount of Savings Needed for Health Expenses for People Eligible for Medicare: Good News Not So Rare Anymore, *by Paul Fronstin, Ph.D., Dallas Salisbury, and Jack VanDerhei, Ph.D., Employee Benefit Research Institute*

- Medicare beneficiaries can expect to pay a share of their costs out of pocket because of program deductibles and other cost sharing. In 2011, Medicare covered 62 percent of the cost of health care services for Medicare beneficiaries ages 65 and older, while out-of-pocket spending accounted for 13 percent, and private insurance covered 15 percent.
- In 2014, a man would need $64,000 in savings and a woman would need $83,000 if each had 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, $116,000 would be needed for a man and $131,000 would be needed for a woman.
- Savings targets declined between 2 percent and 10 percent between 2013–2014. For a married couple both with drug expenses at the 90th percentile throughout retirement who wanted a 90 percent chance of having enough money saved for health care expenses in retirement by age 65, targeted savings fell from $360,000 in 2013 to $326,000 in 2014.

Amount of Savings Needed for Health Expenses for People Eligible for Medicare: Good News Not So Rare Anymore

by Paul Fronstin, Ph.D., Dallas Salisbury, and Jack VanDerhei, Ph.D., Employee Benefit Research Institute

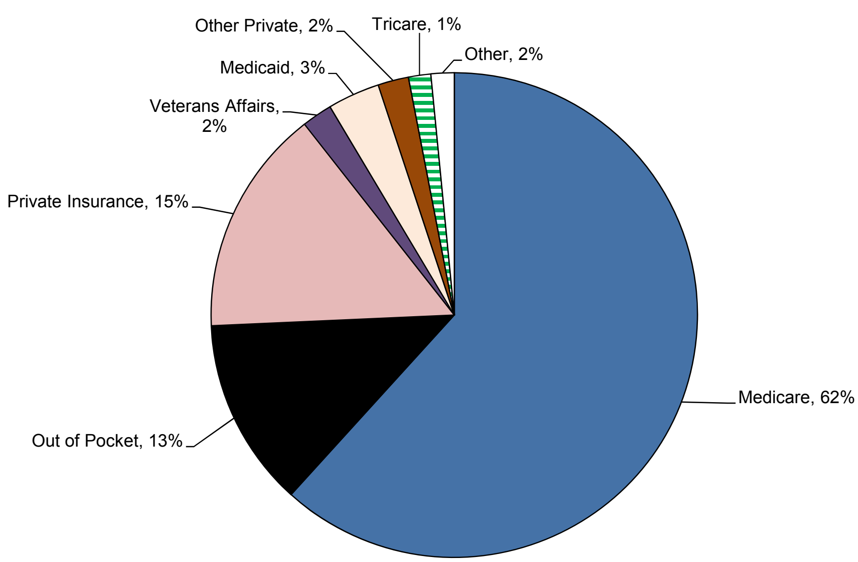
Introduction

In 2011, Medicare covered 62 percent of the cost of health care services for Medicare beneficiaries age 65 and older, while out-of-pocket spending accounted for 13 percent, and private insurance covered 15 percent (Figure 1). Medicare was never designed to cover health care expenses in full. Deductibles for inpatient and outpatient services were included in the program when it was established in 1965.

As recently as 2003, when outpatient prescription drugs were added as an optional benefit, the program included a then-controversial coverage gap known as the so-called "donut hole." While the Patient Protection and Affordable Care Act of 2010 (PPACA) included provisions to reduce the size of this coverage "gap," PPACA did not eliminate it. By 2020, enrollees will pay 25 percent of the cost of prescription drugs when they are in the coverage gap for both generic and brand-name drugs. In the future, individuals may pay a greater share of their overall costs because of the combination of the financial condition of the Medicare program and cutbacks to employment-based retiree health programs (Fronstin and Adams, 2012).

This analysis updates previous estimates by the Employee Benefit Research Institute (EBRI) on savings needed to cover health insurance premiums and health care expenses in retirement (Fronstin, Salisbury, and VanDerhei, 2013). Much like EBRI's 2013 report, this analysis finds that the savings targets for a 65-year-old retiring in 2014 continued to fall, with the decline ranging from 2–10 percent. This report discusses the model, the savings targets, and continued reasons for the decline in savings targets.

Figure 1
Source of Payment for Incurred Health Care Expenses, Noninstitutionalized Population of Medicare Beneficiaries, Ages 65 and Older, 2011



Source: EBRI estimates from the 2011 Medical Expenditure Panel Survey.

Modeling Technique

Determining how much money an individual or married couple needs in retirement to cover health insurance premiums and 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 and source of health insurance coverage to supplement Medicare; health status and out-of-pocket expenses; the rate at which health care costs 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 can use to set retirement savings goals, a single number based on averages will be wrong for the vast majority of the population.

This analysis uses a Monte Carlo simulation model[1] 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 those who supplement Medicare with a combination of individual health insurance through Medigap Plan F coverage and Medicare Part D for outpatient prescription drug coverage. For each source of supplemental coverage, the model simulated 100,000 observations, allowing for the uncertainty related to individual mortality and rates of return on assets in retirement,[2] and 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 are used to determine asset targets for 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.

Savings Targets to Cover Health Insurance Premiums and Out-of-Pocket Costs in Retirement

Figure 2 presents the savings estimates for a person who turns age 65 in 2014 and who purchases Medigap Plan F to supplement Medicare as well as Medicare Part D outpatient drug benefits. It also includes EBRI's prior-year estimates. As discussed above, there is uncertainty related to a number of variables, such as health care costs, longevity, and interest rates. Among people with Medicare Part D, there is also the uncertainty related to health status and prescription drug use.

Figure 2

Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2011–2014

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			
	2011	2012	2013	2014	2011	2012	2013	2014	2011	2012	2013	2014
Men												
50%	$71,000	$70,000	$65,000	$64,000	$80,000	$79,000	$74,000	$72,000	$106,000	$102,000	$96,000	$88,000
75%	107,000	105,000	96,000	93,000	120,000	119,000	108,000	104,000	154,000	147,000	137,000	126,000
90%	136,000	135,000	122,000	116,000	154,000	153,000	137,000	129,000	194,000	185,000	172,000	156,000
Women												
50%	95,000	93,000	86,000	83,000	107,000	106,000	97,000	93,000	138,000	132,000	124,000	114,000
75%	124,000	122,000	111,000	106,000	140,000	139,000	125,000	119,000	178,000	170,000	158,000	144,000
90%	156,000	154,000	139,000	131,000	176,000	176,000	156,000	146,000	221,000	210,000	195,000	176,000
Married Couple												
50%	166,000	163,000	151,000	147,000	187,000	186,000	170,000	165,000	244,000	234,000	220,000	202,000
75%	231,000	227,000	207,000	199,000	260,000	258,000	233,000	222,000	332,000	317,000	295,000	270,000
90%	287,000	283,000	255,000	241,000	323,000	321,000	286,000	270,000	407,000	387,000	360,000	326,000

Source: Author simulations based on assumptions described in the text.

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 2: In the first, prescription drug use is at the median (mid-point, half above and half below) throughout retirement; in the second set, prescription drug use is at the 75th percentile throughout retirement; and in the third set, prescription drug use is at the 90th percentile throughout retirement. Under each set of columns, a comparison of the savings targets is presented for 2011–2014.

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

Median Drug Expenses: As shown in Figure 2, in 2014 a man would need $64,000 in savings and a woman would need $83,000 if each had a goal of having a 50 percent chance of having enough money saved to cover health expenses in retirement. If either instead wanted a 90 percent chance of having enough savings, $116,000 would be needed for a man, and $131,000 would be needed for a woman.

A couple both with median drug expenses would need $147,000 to have a 50 percent change of having enough money to cover health expenses in retirement. They would need $199,000 to have a 75 percent chance of covering their expenses and $241,000 to have a 90 percent chance of covering their expenses. These estimates are 2–6 percent lower than the savings targets estimated in 2013.

75th Percentile in Drug Expenses: Needed savings in 2014 for a man with drug expenditures at the 75th percentile throughout retirement would be $72,000 if he wanted a 50 percent chance of having enough savings to cover health care expenses in retirement. For a woman, the savings target would be $93,000 at the 50-percent target. If either instead wanted a 90 percent chance of having enough savings, $129,000 would be needed for a man, and $146,000 would be needed for a woman.

A couple both with drug expenses at the 75th percentile would need $165,000 to have a 50 percent change of having enough money to cover health care expenses in retirement. They would need $222,000 to have a 75 percent chance of covering those expenses and $270,000 to have a 90 percent chance of covering their expenses. These estimates are 3–6 percent lower than the savings targets estimated in 2013.

90th percentile in Drug Expenses: Individuals at the 90th percentile in drug spending at and throughout retirement experienced an 8–10 percent decline in needed savings in the EBRI model. In 2014, a man would need $88,000 in savings and a woman would need $114,000 if each had 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, $156,000 would be needed for a man, and $176,000 would be needed for a woman.

A couple both with drug expenses at the 90th percentile would need $202,000 to have a 50 percent chance of having enough money to cover health care expenses in retirement. They would need $270,000 to have a 75 percent chance of covering their expenses and $326,000 to have a 90 percent chance of covering their expenses.

Explaining the Decline in Savings Targets between 2013–2014

As mentioned above, savings targets declined between 2 percent and 10 percent between 2013–2014. For a married couple both with drug expenses at the 90th percentile throughout retirement who wanted a 90 percent chance of having enough money saved for health care expenses in retirement by age 65, targeted savings fell from $360,000 in 2013 to $326,000 in 2014.

There are a number of reasons for this decline in needed savings. The EBRI model uses Congressional Budget Office (CBO) and Centers for Medicare & Medicaid Services (CMS) projections for future premium and health care cost increases, and both of their projections of spending growth have slowed in recent years (Congressional Budget Office, 2014) (Levine and Buntin, 2013); EBRI's estimate base lines are adjusted annually to account for this change. As a result, the projected rate of growth of Medicare Part B premiums and Medigap premiums are both lower.

Also, there have been slight improvements in the cost of Medicare Part D. CMS-projected growth rates in Part D premiums and deductible levels have fallen slightly. In addition, using a person who is age 65 in 2014 instead of in 2013 means one less year until the coverage gap in Part D phases down to 25 percent co-insurance.

Conclusion

Individuals should be concerned about saving for health insurance premiums and out-of-pocket expenses in retirement for a number of reasons. Medicare generally covers only about 62 percent of the cost of health care services for Medicare beneficiaries ages 65 and older, while out-of-pocket spending accounts for 13 percent. Furthermore, the percentage of private-sector establishments offering retiree health benefits has been falling. This is also true in the public sector.

This report provides estimates for the savings needed to cover health insurance to supplement Medicare and out-of-pocket expenses for health care services in retirement. PPACA is reducing cost sharing in the Part D coverage gap or so-called "donut hole." By 2020, co-insurance in the coverage gap will be phased in to 25 percent. This year-to-year reduction in co-insurance will continue to reduce the savings needed for health care expenses in retirement, all else being equal, for individuals with the highest drug use, which is one reason why this analysis finds reductions in needed savings for health care expenses in retirement. Improvements in the outlook for growth in premiums and other costs related to the Medicare program also contributed to the decline in savings targets.

However, it should be noted that many individuals will need more than the amounts cited in this report. This analysis does not factor in the savings needed to cover long-term care expenses,[3] 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 past age 65, thereby postponing enrollment in Medicare Parts B and D if they receive health benefits as active workers.

Finally, issues surrounding retirement income security are certain to become an even greater challenge in the future as policymakers begin to realistically address financial issues in the Medicare program with solutions that may shift more responsibility for health care costs to Medicare beneficiaries.

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Endnotes

[1] 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.

[2] 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 provided a median, nominal annual return of 7.32 percent.

[3] See VanDerhei (2006) for estimates of the impact of long-term care expenses on the amounts needed for sufficient retirement income at the 50th, 75th, and 90th percentiles.

Notes

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