September 9th , 2015
Volume 14, Issue 4

Intelligent Money

Current thinking from Haven Financial Advisors

Louis Kokernak CFP, CFA
Haven Financial Advisors

voice 512 791 4335
louis@havenfinancial.com

Special Notes of Interest:

McKinsey Global Institute estimates that companies in the emerging markets are likely to account for 40–50% of the Fortune Global 500 by 2025

The 12 month inflation rate through July 2015 was only 0.2%. August data to be released on the 16th.

The Demise of Retiree Medical Benefits

There is a movement afoot in corporate America. Companies are dropping retirees from their group medical insurance plans. As of 2013, only 28% of companies with more than 200 people administer their own retiree medical benefit programs. Two thirds did in 1988. Household names such as IBM and GE have shifted some or all of their retirees to private insurance exchanges. This article will review this trend and its implications for those approaching retirement.

Background

Larger employers adopted a paternalistic view of health care dating from the second world war. Wage and price controls coupled with labor shortages compelled companies to be creative in attracting employees. Offering health benefits was a suitable way to accomplish the task within the confines of the law. Government tax policy cooperated by allowing corporations to deduct the cost of health programs.

Health coverage became common for active employees. Before long, companies began managing health insurance for their retirees as well. Employer group plans dovetailed with Medicare benefits – supplementing Medicare once the retiree turned 65. Those that retired from large employers paid very little for acute medical care. Even today, about one in three Medicare eligible retirees is covered by an employer or union health plan.

Until 1990, companies funded these programs on a pay as you go basis. In December of that year, the Financial Accounting Standards Board promulgated rule 106 (FASB 106). The new rule required accrual of the expected cost of providing those benefits to an employee. In a nutshell, companies had to carry the expected cost of retiree medical benefits on their books. In 2013, Fortune 1000 companies reported $285 billion in retiree medical liabilities to the SEC. Those are big numbers.

It was a wakeup call for corporate America. With the stroke of an accountant's pen, companies lost some flexibility in the funding of health expenses. Their income statements would now reflect the substantial costs of supporting employees after separation from service.

These costs have been growing rapidly. Mercer consulting's survey of group health care benefits revealed that they have increased at an annual rate of nearly 7% since calendar 2000 – well in excess of headline inflation (CPI). Most analysts expect that trend to continue.

The Corporate Response

People in business do not like unpredictable costs. Providing open ended support for health benefits to former employees has fallen out of favor. Most employers do NOT feel that the financial support they provide post retirement is recognized as a benefit. Only 17% of plan sponsors believe that their employees appreciate the financial cost of retiree medical benefits[1]. Only one in seven thinks that the benefits are important to their organization's total reward strategy.

Rather than exit the game, America's largest companies have sought to create some cost certainty in health care. The commitment is taking a different form, however. Many are moving retirees to account based health plans (ABHPs) that operate with private insurance exchanges. The employer provides a predetermined premium subsidy and educational tools to facilitate the retiree's health insurance decision. The retiree typically chooses among Medicare Advantage plans. More on that later.

As an example, General Electric Co. discontinued its group health plan for retired salaried workers at yearend 2014. Now, it is providing them with $1,000 a year to buy a health insurance on a private exchange. The company recently announced similar program changes to its hourly employees starting January 1st, 2016.

Even those employers who retain the traditional retiree health insurance plan are requiring more financial commitment from participants. 60% say their 2015 plan costs already exceed the targets they've established. Concerned, 34% are altering plan design,

with 30% changing employer subsidies and formulas for cost sharing with employees[2].

The Issue is Big

The stakes for a retiring couple are high. *Healthview Services* published a survey of anticipated health care premiums and out-of-pocket premiums for 65 year old and 55 year old couples. Fidelity Investments arrived at similar numbers last year. As the table below illustrates, the expenses run well into six figures.

The best time to buy a Medigap supplement is during the 6 month initial enrollment. This period starts the month you turn 65 and enroll in Medicare Part B. If you enroll during this period, you cannot be charged a higher rate because of poor health.

Medicare Advantage plans are private health insurance — most often HMOs and PPOs — that Medicare offers as a coverage alternative to the traditional program. Every plan must cover all the same benefits that traditional Medicare covers. But the plans can require lower copayments and

A Comparison of 2013 and 2014 Total Health Care Projections*				* in Future Dollars
Couple' s Age	Life Expectancy	Retirement Year	Projection for Part B, Part D, Supplemental, and cost sharing based on 2014 data	Projection based on 2013 data
65	87, 89	2015	402034	382500
55	86, 89	2025	645466	612691

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For most Americans, healthcare costs are a critical factor in determining retirement outcomes. Unlike food and travel, the level of health care required is highly variable and involuntary. Medicare does NOT cover all one's medical expense and there is no limit to what you can spend out of pocket without additional insurance.

It is important to obtain insurance coverage to supplement Medicare. For much of the twentieth century, this was an afterthought for America's working professionals. Their employer provided an adequate insurance supplement at little or no cost. Today about one third of retirees have retiree medical benefits that are subsidized by their employer. That fraction will fall substantially over time for the reasons described above.

Today's workers will have to provide for themselves. There are choices to be made. Medigap and Medicare Advantage are two major privately contracted options.

Medigap plans are highly regulated policy forms that are offered by private companies. Each of the 10 types of Medigap policies is standardized — meaning the benefits of each are the same, regardless of which insurer sells it. Prices do vary across insurers. In Texas, the average policy costs about $200 per month and has been increasing faster than headline inflation.

offer extra benefits. Many subsidize prescription drugs. Most charge a monthly premium in addition to the Medicare Part B premium.

Medicare Advantage plans have annual limits on out-of-pocket costs. Another difference from the traditional program is that most plans require you to go to doctors and other providers within their service network or pay higher copays for going out of network. You cannot buy both Medigap and Medicare Advantage insurance.

There are a lot more options in the Medicare Advantage marketplace. You can sign up for one of these plans at the same time you become eligible for traditional Medicare. Thereafter, there is an open enrollment period that runs from October to December that allows retirees to change coverages subject to certain limitations.

Those covered by employer medical benefits should consult with their employer before obtaining a Medigap or Medicare Advantage policy. Coverage will likely overlap and may cause the retiree to lose employer benefits.

Today roughly 40% of retirees are enrolled in either Medigap or Medicare Advantage programs. That fraction will almost certainly increase. Moreover, the individual will be supporting most or all of the actuarial cost of the coverage. That is a considerable financial burden for most retirees. All the more reason to plan well in advance of retirement.