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TRENDS AND ISSUES

EARLY RETIREE HEALTH INSURANCE ISSUES

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EXECUTIVE SUMMARY

Individuals considering early retirement, i.e., retirement before age 65, must not only carefully plan their financial resources, but they should also plan for health insurance coverage till age 65 when eligibility for Medicare begins. They must also plan for supplemental health insurance coverage for age 65 and beyond. The Employee Benefit Research Institute has estimated that a couple, both age 65 with average life expectancy, would need as much as $295,000 to cover premiums for health insurance and out-of-pocket expenses during retirement. For early retirees, the costs would be even higher.

Important issues for individuals to factor into their planning include:

- Coverage of retirees by their former employers is becoming both less common and less generous when it is still available. The rapid increases in costs of health insurance coverage in recent years mean that employers are finding it difficult to afford these benefits. Between 2005 and 2006, retiree insurance costs rose 6.8 percent. Because of employers passing on a larger share to retirees, however, age 65+ retirees faced a 9.6 percent increase in their premium contributions and pre-65 retirees faced increases averaging over 15 percent. More than 80 percent of employers surveyed indicated that they plan to increase retiree contributions in the future.
- Nonetheless, with few exceptions, those who have access to employer coverage should try to qualify, because this insurance is likely to be less expensive than plans available in the private individual insurance market.
- It is crucial for people planning to retire early to check with the benefits office of their employer to find out not only what is available at retirement, but under what conditions. Often, the rules for pensions and retiree coverage are not the same. For example, many employees do not qualify for health insurance unless they have both a specific number of years of service with the company and carry the insurance for several years before retirement. This latter requirement is particularly important to check on regarding spousal coverage.
- For people retiring before age 65 and without employer coverage, it is important to shop carefully; there are several options available—all of them likely to be expensive. Indeed, one reason many people work longer than they would like is to maintain their health benefits. Available options vary by the state in which an individual resides since states establish the rules that govern sale of individual

insurance policies. Options for individuals vary depending upon their health status, with coverage much more difficult for those with health problems. They may find that they cannot get insurance at any price, or are only offered such coverage with major limitations.

TABLE OF CONTENTS

Introduction 5
Access To Retire Coverage 5
Buying Insurance On The Private Market 8
About The Author 10

INTRODUCTION

People retiring before the age of 65 need to carefully examine not only their financial status, but their access to good health insurance coverage as well. Although people can draw Social Security benefits at age 62, they must wait until age 65 for Medicare coverage (unless they have severe disabilities that qualified them for Social Security disability for two years). Thus, retirees need to think ahead about where they will get their health insurance at least until they turn 65 (and how they will get supplemental coverage at 65 and above). Failure to do so can result in thousands of dollars of additional expenses.

ACCESS TO RETIRE COVERAGE

Fortunate retirees will have insurance from their former employer or a spouse's current or former employer. Such coverage is becoming rarer each year, however. Many employers who do not have to deal with union contracts are announcing cutbacks or even elimination of their retiree health benefits. Just because someone who retired a few years ago has it from a company is no guarantee that future retirees will receive such coverage. Employers can cut off benefits to future retirees at will since these represent voluntary offerings; the rapid increases in costs of health insurance coverage in recent years mean that employers are finding it difficult to afford these benefits; thus, retirees should be careful to protect their access to insurance whenever possible.

One survey in 2006 found that the annual cost of retiree premiums was $6,624 for a pre-65 retiree and $3,240 for a new age 65 and above retiree. The average retiree contributions were $2,724 and $1,320 respectively. Between 2005 and 2006, retiree insurance costs rose 6.8 percent. Because of employers passing on a larger share to retirees, however, age 65+ retirees faced a 9.6 percent increase in their premium contributions and pre-65 retirees faced increases averaging over 15 percent. More than 80 percent of employers surveyed indicated that they plan to increase retiree contributions in the future.[1]

It is crucial for people planning to retire early to check with the benefits office of their employer to find out not only what is available at retirement, but under what conditions.

[1] Kaiser Family Foundation and Hewitt Associates, December 2006.

Often, the rules for pensions and retiree coverage are not the same. For example, many employees do not qualify for health insurance unless they have both a specific number of years of service with the company and carry the insurance for several years before retirement. This latter requirement is particularly important to check on regarding spousal coverage. Many current workers find it is cheaper to each have their own individual coverage from their own employer. But the rules may omit spousal retiree coverage if that person did not have coverage for the last several years that the employee was actively working. This is one reason why people sometimes end up with multiple coverage for a few years before retirement.

It usually will not make sense to carry two sets of *retiree* coverage, however; rather a couple should look at whose coverage is the better and judge the likely stability of that coverage over time. Has the employer been cutting back or threatening to do so in the recent past? What is the ratio of retirees to current workers? A heavy retiree burden on an industry or a particular employer may increase the likelihood of the employer scaling back over time.

Employers have a number of ways in which they try to limit their liabilities. One way is to offer coverage only until a former employee reaches eligibility for Medicare. The question of whether an employer can offer retiree coverage for just a few years is up in the air because of some recent court cases, however. At this point, employers will likely be required to offer insurance coverage for all retirement years (if they offer it at all) because of rulings about age discrimination. Unfortunately, some analysts fear this may cause employers who were only offering benefits up to age 65 to drop coverage altogether, so anyone contemplating retirement should check on this closely as there may be changes over the next few years. Insurance coverage usually changes at 65, however, when beneficiaries become eligible for Medicare. Medicare is primary, and most employers will only cover what Medicare does *not* cover at that point. This aspect of retiree coverage will not change.

In addition to raising premiums and cost sharing routinely each year as health care costs rise, some employers are also placing caps on how much their contribution will go up each year. The effect of this is to have costs to retirees rise even faster than the increase in the general costs of health care because the former employer is limiting liability and passing it off onto retirees. These approaches are relatively new but will have a greater impact

over time when the contribution limit grows at a slower rate than health care costs and more and more is passed onto retirees. Already, nearly half of all employers have added such caps.[2]

The Medicare Part D prescription drug benefit subsidizes employers who offer coverage at least as generous as the required standard option for Medicare. This may well have slowed the trend of employers cutting retiree benefits since the federal government will contribute to at least some of the costs of this coverage. The survey of retiree benefits described above found that in 2007, 78 percent of surveyed employers intend to take the subsidy and hence will continue to offer generous prescription drug coverage.[3]

In most cases, if the employer subsidizes retiree health insurance premiums, the coverage will be a much better deal than anything available on the private market. The costs of insurance to employers are cheaper for the same policy one could buy individually because the employer handles the costs of enrollment and providing information. Also, normally there are no pre-existing condition exclusions (such as limiting coverage for any recurrence of cancer, for example) on employer-based coverage that might be present when people go to the private market to purchase coverage. In 2006, about 17 percent of employers required retirees to pay the full cost—a share that is likely to rise over time.[4] If the employer only allows retirees to buy into the insurance plan at its full costs, then it makes sense to compare the costs with other insurance that might be available. Employer coverage may be more generous than what individuals wish to have, for example, in which case other plans might be cheaper. Managed care organizations often offer coverage that will be less expensive than a full, unrestricted policy that an employer may offer. Moreover, when Medicare is primary after age 65, supplemental coverage may be less expensive than the full costs for comprehensive employer coverage.

Another employer-related option is to get "COBRA" coverage. Named after the acronym for otherwise unrelated legislation, COBRA protections require that employers with more than 20 employees offer access to their health insurance system for a period of time once an employee terminates employment. In the case of an early retiree, this would generally be 18 months. For a person 18 months or less away from Medicare eligibility, COBRA

[2] Paul Fronstin, "Savings Needed to Fund Health Insurance and Health Care Expenses in Retirement," EBRI Issue Brief, July 2006.
[3] Kaiser and Hewitt, December 2006.
[4] Kaiser and Hewitt, 2006.

coverage will fill in the gap, for a price. Individuals pay 102 percent of the costs of that coverage, amounting to as much as $4,000 to $5,000 per year for one person. After that period, the individual will have to find private insurance coverage.

BUYING INSURANCE ON THE PRIVATE MARKET

For people leaving their jobs before age 65 and without employer coverage, there are several options available—all of them likely to be expensive. Indeed, one reason many people work longer than they would like is to maintain their health benefits. Available options vary by the state in which an individual resides since states establish the rules that govern sale of individual insurance policies.

The easier it is to obtain individual coverage, the more expensive the policy likely will be. Why is that? States rules to ensure access to insurance to all individuals result in sicker people being accepted into the insurance pool. As a consequence, costs of such policies need to be higher. This situation is good for people with known health problems because they can get insurance, but the impact on those who are healthy is more expensive coverage. This conundrum has resulted in a number of states first passing laws guaranteeing access to insurance, for example, and then repealing them when complaints roll in about rising insurance premiums.

Options for individuals vary depending upon their health status. People in very good health (meaning few if any existing health conditions, however minor) may be able to find relatively inexpensive plans. Managed care organizations or Blue Cross/Blue Shield plans in particular may be available. But the issues are much more difficult for those with health problems. They may find that they cannot get insurance at any price, or are only offered such coverage with major limitations. For example, someone who has had cancer but with no recurrence for many years may still be excluded from receiving insurance protection for any future type of cancer.

One response that states have made is to offer coverage through "high risk pools" that cover people with substantial health problems. But such insurance tends to be very expensive since states offer only minimal or no subsidies. This option works for people with very great risks who have enough income to buy the insurance, but likely is not a

good option for people with modest incomes seeking retiree insurance coverage before they turn 65.

Some states have guaranteed enrollment for certain categories of people, such as those who are self-employed. Even minimal amounts of self-employment income (usually documented when a person files Schedule C on their federal personal income tax forms) can give an individual access to a basic plan—although it may be a bare bones type plan.

Another option and one that is increasingly available are plans that come with very high deductibles. Such plans may require individuals to bear the costs of the first $5,000 or $10,000 of expenses before paying anything. This is truly catastrophic insurance and offers upper bound protection when other insurance is not available or too costly. But an important caveat for people to note is that a $5,000 deductible may not be met until someone has spent much more than that on health care costs. For example, if the insurance company determines that a physician visit costing an individual $150 should only cost $50, it is the $50 that counts toward the deductible and not $150. In comparing these high deductible plans with other insurance, people need to find out exactly what counts toward the deductible.

High deductible plans are becoming more attractive because of legislation passed in 2003 that allows individuals to combine this type of insurance with a health savings account into which individuals can deposit tax-exempt dollars to help pay for the costs of uncovered expenses. These health savings accounts can be rolled over from year to year, unlike the flexible health savings benefit plans that many people now have through their employers. In other words, there is no "use it or lose it" requirement. This option is particularly attractive to people in high tax brackets and who can afford to pay the substantial deductible out of pocket until they have accumulated enough in the HSAs to meet those expenses. Moreover, people able to keep a positive balance in their accounts each year will be able to carry those funds over to meet obligations in their retirement years.

How much can all of this add up to be? The Employee Benefits Research Institute has estimated that a couple, both age 65 with average life expectancy, would need as much as $295,000 to cover premiums for health insurance and out-of-pocket expenses during

retirement.[5] This assumes that the retiree pays the full costs for employer-offered coverage. And even if the costs were partially subsidized, the amount retirees must pay would still be counted in six figures. For early retirees and those forced into the individual insurance market, the costs would be even higher. Thus, it is important to plan ahead and keep in mind costs of health coverage during retirement.

ABOUT THE AUTHOR

Marilyn Moon, Ph.D., is Vice President and Director of the Health Program at the American Institutes for Research. She also serves as a TIAA-CREF Institute Fellow. A nationally-known expert on Medicare and social insurance, Dr. Moon previously served as a Senior Fellow at the Urban Institute and as a public trustee for the Social Security and Medicare trust funds. Dr. Moon has published extensively on health policy, both for the elderly and the population in general, and has served on a number of boards for non-profit organizations. Currently, she is president of the board of the Medicare Rights Center. She earned a Ph.D. in economics from the University of Wisconsin-Madison.

[5] Fronstin, 2006.