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Underestimating Healthcare Expenses

Even as more and more employers drop their healthcare coverage for retirees, a new study shows that health-savings accounts will not provide retirees with adequate savings to pay for their healthcare expenses. HR leaders need to offer more education and assistance.

By Leah Shepherd

April 21, 2010

With the recent passage of the healthcare reform bill, many employers and HR leaders are looking for answers about the effect on health-savings accounts and retiree healthcare, in general.

"HSAs have done pretty well in healthcare reform," says Mike Thompson, a principal at PricewaterhouseCoopers in New York, noting the new legislation generally leaves intact the legal and tax structure of the HSAs.

Some experts say the reform bill may lead to more employees enrolling in HSAs since companies may opt to offer such a benefit as a way to avoid the penalty on organizations that do not provide healthcare benefits to workers.

However, budget cuts for Medicare could increase the amount of money needed to pay for medical expenses in retirement. While a provision to phase out the so-called "donut-hole" in pharmaceutical coverage under Medicare Part D "actually will mitigate some of the cost" for retirees, overall, "people should expect to pick up a bigger part of the burden over time," Thompson says.

And, he notes, "we still haven't dealt with the solvency of Medicare."

At the same time, healthcare reform should accelerate the number of employers that are dropping retiree healthcare coverage, according to experts.

"I don't think we're going to return to the days where the employer's going to provide total health security for life. That's too big a promise for employers," Thompson says.

All of which means there may be more uncertainty in store for today's employees as they try to save for retiree-healthcare expenses. HSAs cannot offer much comfort.

Such accounts will not be sufficient to pay for the expected medical expenses in retirement, according to new research from the Employee Benefit Research Institute in Washington.

That's because the legal contribution limits and low interest rates restrict the amount of money HSAs are able to accumulate, compared with the enormous amount needed to pay health bills during retirement.

"It certainly is no surprise," says Paul Fronstin, a senior research associate at EBRI. "You can only put in so much by law. It's just not enough."

"HSAs can be part of the tools," Thompson agrees. "It's helpful, but not enough."

EBRI analyzed the use of HSAs to generate savings needed to cover retirement-related health-insurance premiums and out-of-pocket healthcare expenses, using both estimated Medicare payments and earlier EBRI research on retiree health costs.

For example, if a 55-year-old man in 2009 contributed $3,000 to his HSA and contributed the $1,000 catch-up contribution each year for 10 years, a total of $48,300 would be in the account after 10 years (assuming a 2-percent interest rate). If the interest rate was 5 percent, $55,100 would be accumulated after 10 years.

But that amount is only about one-third of what's needed -- at best -- since EBRI estimates that a 55-year-old man in 2009 needs between $144,000 and $290,000 by the time he reaches age 65 to have a 50-percent chance of being able to cover premiums and out-of-pocket expenses for Medigap and Medicare Part D.

In fact, an HSA can only accumulate between 16 percent and 32 percent of the total needed to have a 50-percent chance of being able to cover healthcare expenses, according to EBRI. For a 90-percent chance, the maximum HSA savings would only cover between 7 percent and 16 percent of the total needed.

Women would need to save more because they live longer, on average, than men.

In addition, keep in mind that any HSA distributions before retirement will "erode the value of the account," making it harder to save the total amount needed in the retirement years, Fronstin says.

Medical expenses in retirement are high because people tend to have more health problems as they age, and Medicare does not cover many items, such as routine dental care, hearing aids, eyeglasses, routine physical exams and custodial care in a nursing home. Once enrolled in Medicare, beneficiaries cannot continue making contributions to an HSA.

Thompson agrees: "Costs are significant outside of what Medicare pays. It's a serious issue."

Tips for Employers

Human resource leaders should carefully consider the way they market HSAs to employees.

"If they're selling this to their workers as the solution for paying for healthcare in retirement, it's just not going to cut it," Fronstin warns. He recommends teaching employees about other ways to save for retirement, such as getting the maximum employer match in the 401(k), which many workers don't do.

Employers "need to present the comprehensive view of really what it's going to take" to pay for healthcare in retirement, he says.

Thompson agrees more education is needed.

"People often undervalue, underestimate, health expenses in retirement," he says. "They don't know what Medicare doesn't pay for.

"Where we're headed is an era where people have to take more accountability for their personal security. It used to be the employer took care of [workers] for life. ... Employees haven't always picked up the ball and prepared themselves adequately," Thompson says.

Employers need to create "an enabling environment, so people are aware of the risks they face as they enter retirement," Thompson says, noting that if older workers are not well-prepared for retirement, employers could see too much "job lock" when those employees don't retire.

"It's a fair assessment to say, under any assumptions, people aren't saving enough," he says.