

The retiree healthcare challenge: Driving better retirement outcomes and enhancing employee well-being

DC retiree healthcare approaches offer a powerful triple-tax advantage that could stretch benefit dollars up to 50%.¹

As an employer, you offer a benefits package that supports your core employment goals to recruit, retain and allow your employees to retire at a traditional retirement age. However, the third pillar of your employment offer—a timely retirement—may be strained by the magnitude of retiree healthcare costs Americans face.

Increasingly, people entering retirement today will not receive retiree healthcare coverage from their employer. Many employers are hesitant to maintain or add a retiree health benefit. This trend may be creating more problems than it is hoping to solve. It's important to consider how not addressing retiree health affects workforce management strategies and employees' ability to manage healthcare costs in retirement.

More importantly, your employees—especially Baby Boomers—may be considering delaying retirement due to healthcare expenses. The reality is that a majority of Americans (60 percent) are concerned about how they will pay for healthcare expenses in retirement.² This issue is likely to increase as greater life expectancies and healthcare inflation continue to drive healthcare costs. That's why you may want to consider addressing this challenge today to help drive better retirement outcomes for your employees.



What's needed?

Consider a total benefits approach that complements your existing retirement plan offering and takes into consideration your organization's financial situation. That means making the most of existing benefits dollars and discovering cost savings across different programs to fund new or more effective retiree healthcare solutions. It also means making the most out of available tax incentives. A defined contribution (DC) retirement healthcare approach that offers triple-tax benefits may be part of that solution.

Retiree healthcare costs are a real concern

Meeting the cost of healthcare in retirement is a complex challenge for Americans who know what to expect. It's an even greater challenge for Americans that don't understand the potential magnitude of retiree healthcare costs until they begin to approach retirement.

An average 65-year-old couple today will need \$265,000 to cover out-of-pocket healthcare expenses in retirement.³ Many Americans are ill-prepared for these expenses and are under the false impression that Medicare covers most of these costs. The reality is that retirees are responsible for Medicare premiums, deductibles and coinsurance; routine dental, vision and hearing care; and a range of other expenses. Long-term care costs are also not covered by Medicare (nor are they included in the out-of-pocket estimates) and can be quite substantial and vary significantly depending on the care needed, length of illness and state of residence. Any meaningful discussion about retirement readiness must include planning for healthcare expenses.

Retirement plan success includes addressing the retiree healthcare gap

Some employers may still offer traditional defined benefit solutions to tackle retirement healthcare expenses, but because of their cost, they are commonly grandfathered benefits. This often results in a coverage gap between older and younger employees and could have future workforce and retirement outcome implications.

Ultimately, fewer people entering retirement today are likely to receive retiree healthcare benefits from their employer. Without employer-sponsored retiree health benefits, employees bear the full burden of saving for retirement healthcare expenses. Worse yet, they may ignore the issue altogether.

Fewer employer-provided retiree healthcare benefits could result in cost-savings for employers, but it also may have unintended consequences.

Healthcare is one of the largest expenses facing retirees



62%

Total healthcare costs Medicare may cover.⁴



15% vs 8%

Healthcare spending will outpace total consumption spending growth rates over the next decade. Older populations could see even higher healthcare spending growth rates between 20% and 25%.⁵



14%

Average annual healthcare expenses as a percent of income for those age 75 and older—significantly higher than the 8% for those 55 to 64.⁶

Delayed retirement: Employees may choose to postpone their retirement date to save more and remain covered by their employer's health plan. This may affect total compensation strategies and active health insurance risk pools. Older workers typically earn more and drive higher overall health insurance costs than younger employees.

Depletion of retirement income: Increasing healthcare costs in retirement place a significant burden on retirement income sources. Employees saving through their work-based retirement plans typically aren't saving enough to account for out-of-pocket healthcare costs. Retirees paying for medical expenses from their retirement savings plan could run through their savings faster than expected and outlive their nest egg.

A more effective approach may be to help employees think about and plan for retirement healthcare expenses early, so they can approach retirement with confidence. Planning for healthcare costs in retirement should be part of a comprehensive health and wealth strategy—one that helps employees pursue a sense of financial well-being and has them think it's OK to retire.

DB solutions straining balance sheets

Defined benefit retiree healthcare plans were once a common employee benefit. But, changes in accounting standards required employers to account for retiree healthcare benefit promises as a current liability.⁷ Many employers eliminated DB benefits as a result, but those that didn't may find it difficult to manage their mounting accounting liabilities.

Going forward, changes in demographics, healthcare inflation and accounting standards are making it increasingly difficult for employers to continue offering defined benefit retiree healthcare solutions. One potential solution would be to wind down existing DB solutions and replace them with a more cost-effective DC approach. DB plan savings could fund a new DC solution while maintaining or potentially reducing existing costs.

Benefits of a DC retiree health approach



Control costs

- Employers decide how much they contribute
- Costs are realized today, without future liabilities
- Reduce or eliminate DB benefit liabilities and financial statement requirements



Drive timely retirements

- Improves likelihood that employees will reach retirement with adequate savings for retiree healthcare expenses
- Helps reduce concerns over losing employer healthcare coverage



Maximize compensation costs

- Triple tax benefits
 - Employer contributions are made tax free
 - Earnings grow tax free
 - Distributions are tax free
- Depending on employee's tax-bracket, may be able to stretch benefits dollars by up to 50%⁸



Strengthen employment offer

- Complements existing retirement plan solutions offered
- More competitive benefits offer supports employee recruitment and retention efforts

Not all defined contribution approaches are the same

With DC-like approaches to healthcare benefits becoming more common for active employees, it's important to understand how they work. Three common approaches include HSAs, HRAs and RHSPs.

Health Savings Accounts (HSAs): Increasingly, HSAs are utilized to help employees save for retiree healthcare expenses. However, to contribute to a HSA, the account holder must also be enrolled in a qualifying High Deductible Health Plan. Further, a HSA is designed to help employees manage current healthcare expenses and most account holders spend their HSA balance each year making it difficult to accumulate savings for retirement.

Health Reimbursement Accounts (HRAs): HRAs are entirely funded by the employer and can be established for both active employees or retirees. Generally, a retiree HRA will not provide long-term investments and the contribution is an annual “pay as you go” stipend that the retiree can use for premiums or other out of pocket medical expenses in retirement. As a pay-as-you-go benefit, the annual stipend can represent a liability on the employer's balance sheet. The annual stipend is often a fixed dollar amount and unless the employer increases the stipend over time, the retiree will bear the burden of increased healthcare expenses throughout retirement.⁹

Retirement Health Savings Program (RHSP): A RHSP is an employer sponsored plan funded by the employer and may allow employees to contribute on an after-tax basis. Unlike the typical HRA, a RHSP is fully funded with contributions made throughout the working career of the employee. The employee often has the option of selecting how contributions are invested among a series of mutual funds. During the employee's career, the RHSP resembles a 403(b) or 401(k) plan but in retirement it provides a completely tax-free reimbursement account to pay for qualified medical expenses.¹⁰

Exploring a defined contribution approach

A defined contribution (DC) approach—such as a Retirement Health Savings Program (RHSP)—can help address both your institution's financial concerns and your employees' needs. A DC approach allows employees to save for retirement healthcare expenses, while you maintain control over institutional costs.

A fully-funded defined contribution plan can help solve employer and employee challenges

Many employers are already moving towards DC-like approaches to healthcare benefits for active employees. The use of High-Deductible Health Plans matched with Health Savings Accounts has helped to lower employer healthcare costs and made them more predictable, while giving employees an additional option to meet current healthcare expenses.

The RHSP makes it possible to take a similar approach to help employees plan for—and pay for—healthcare expenses in retirement. It can help employees manage their retirement healthcare expenses without adding unnecessary cost or complication to your institution's balance sheet.

Integrating a retiree health benefit doesn't have to mean increased costs. Taking a total benefits approach could yield the necessary funding to support a RHSP offering. For example, potential savings generated by shifting from an HMO to a HDHP offering could be sufficient to cover your employer contribution and administration costs. The key is to evaluate your benefits from a holistic perspective to identify potential opportunities for improvement.

Drive better retirement plan outcomes

Offering a retirement plan that focuses on income replacement is an effective way to help employees prepare for retirement and ensure they are on track to meeting their goals. You can further help your employees pursue better outcomes by offering a DC retiree health approach that works in tandem with your retirement plan. That way you'll be addressing both employees' health and financial well-being: Two factors that are vital to living comfortably in retirement.

A fully funded defined contribution strategy allows employees to save for retirement healthcare expenses, and employers can maintain control over:

- Their institutional costs
- Their total compensation budget
- Potential workforce management issues

Balancing what's best for your institution and employees

Healthcare is one of the largest expenses retirees may face as they get older, and it can have a significant impact on their savings. The sooner workers begin planning for retiree healthcare, the more manageable those future costs can be. By taking a comprehensive view of your benefits, you can provide an effective retiree healthcare solution for your employees while addressing the difficult fiscal environment employers are facing.

Evaluating your options

The following checklist offers five steps to consider when assessing retiree healthcare solutions.

Understand your employee demographics and how they affect your organization.

- Retiree healthcare costs could be contributing to employees delaying retirement.

Take a comprehensive look at employee retirement readiness

- Participant retirement savings may not be accounting for out-of-pocket healthcare costs.

Re-visit your current retiree healthcare benefits.

- Evaluate not just the financial impact of these solutions but also their effectiveness.

Take a total benefits approach to manage costs and deliver value to your employees.

- Taking a total benefits approach can help you minimize your liabilities while maximizing your total benefits spend.
- Cost savings in one benefits area could help fund new retiree healthcare solutions.

Explore retiree healthcare solutions that meet your organization's needs.

- Consider their cost, effectiveness, ease of administration and how they may affect your workforce renewal strategy.



To learn more about how a RHSP can be an effective complement to your existing retirement offering, and an important part of your workforce recruitment, retention, and renewal strategy you can:

- Contact your Relationship Manager
- Visit emeritihealth.org
- Call Rod Crane at (303) 607-2896.



1. This is based on the results of a hypothetical illustration where \$2,000/year was contributed into both a Retiree Health Care Account (RHCA) and a 403(b) plan for 30 years. The assets in both accounts grew at a 6% interest rate each year and this resulted in an after-tax total accumulation amount of \$162,419 from the RHCA compared to \$108,821 from a tax-advantaged retirement savings plan. This assumes a 33% tax-rate.
2. <http://www.lifehealthpro.com/2016/08/18/most-americans-concerned-about-health-care-expense>.
3. EBRI Notes, January 2017, Vol. 38, 1, National average. Savings needed for Medigap Plan F premiums, Medicare Part B premiums and out-of-pocket (median) drug expenses, Savings needed to have a 90% probability of having enough funds to pay for out of pocket medical expenses assuming the retirees are enrolled in Medicare Part A & B, purchase a Medicare Supplement Plan F and Medicare Part D prescription drug coverage. Costs include premiums, deductibles, co-pays, average drug expenditures and other out of pocket costs not covered by insurance. The estimate does not include the cost of Long Term Care services or insurance.
4. National Institute on Aging, Newsroom, Dramatic changes in U.S. highlighted in new census, NIH report, June 26, 2013
5. The Conference Board, The Impact of Demographic Trends on Consumer Spending, Research Report R-1622-KBI, 2017
6. LIMRA Secure retirement Institute, Annual Fact Book 2015
7. For private institutions, Financial Accounting Standard (FAS) 106 changed the retiree medical playing field, and Government Accounting Standard Board (GASB) 43 & 45 has driven changes among public employers more recently.
8. This is based on the results of a hypothetical illustration where \$2,000/year was contributed into both a Retiree Health Care Account (RHCA) and a 403(b) plan for 30 years. The assets in both accounts grew at a 6% interest rate each year and this resulted in an after-tax total accumulation amount of \$162,419 from the RHCA compared to \$108,821 from a tax-advantaged retirement savings plan. This assumes a 33% tax-rate.
9. Employers that back their HRAs with an irrevocable trust such as a VEBA may not find themselves with a liability on their balance sheet.
10. RHSPs are funded with an irrevocable trust such as a VEBA.

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