



## Planning for Retirement: The Distribution of Lifetime Healthcare Costs

While many individuals look forward to their retirement, healthcare costs loom as a large risk, making it difficult to determine how much to set aside in planning for retirement. Using projected healthcare costs for the average household may be a good starting point, but this approach does not address the risk that some will incur unusually high expenditures that could seriously deplete their financial assets. In order to plan for healthcare costs, households need to better understand the uncertainty regarding lifetime healthcare costs once they reach age 65.

The Center for Retirement Research at Boston College (CRR) conducted research to obtain a better understanding of the magnitude, distribution, and determinants of healthcare costs during retirement.<sup>1</sup> The points below summarize CRR's methodology and findings. More detailed results can be found in the CRR Issue in Brief, "What is the Distribution of Lifetime Health Care Costs From Age 65?" by Anthony Webb and Natalia Zhivan, and the authors' underlying working paper.

The research was conducted using the *Health and Retirement Study* (HRS),<sup>2</sup> which follows, over time, a nationally representative sample of older Americans. Because HRS data are available for only 16 years, and only a small and unrepresentative proportion of those over 65 have died, the CRR researchers used the HRS data to simulate over 300,000 health, mortality, and healthcare cost histories for each HRS household from age 65 until the end of life.

### Findings

- The average remaining uninsured lifetime healthcare expenditure for a typical married couple aged 65 is \$197,000. This amount represents the present value of the couple's premiums for Medicare and private insurance, out-of-pocket payments, and home care costs, but does not include nursing home care. Moreover, couples have a 5% risk that the total expenditure will exceed \$311,000 (see Figure 1). Even at the peak of the stock market in 2007, only about 20% of households approaching retirement had accumulated that much in financial assets.<sup>3</sup>
- For many, nursing home costs can significantly increase healthcare costs in retirement. Layering in nursing home costs increases the average cost to \$260,000 and renders a 5% chance that a couple's healthcare costs will exceed \$570,000<sup>4</sup> (see Figure 2). Nursing home care costs can be quite substantial. In 2008, the annual cost of nursing home care was about \$79,000 for a private room.<sup>5</sup> About one-third of individuals turning 65 in 2010 will need at least three months' nursing home care, 24% will need more than one year, and 9% will need more than five years.<sup>6</sup> Medicare pays for a maximum of only 100 days of nursing home care.

## Remaining Lifetime Healthcare Costs at Selected Ages: Average and Top Five Percent

Figure 1. Excluding Nursing Home Care

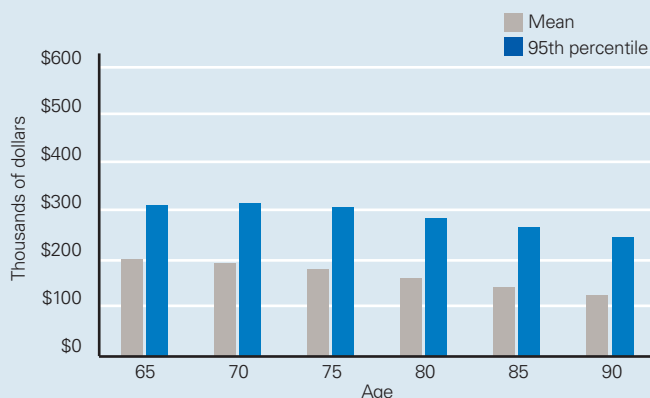
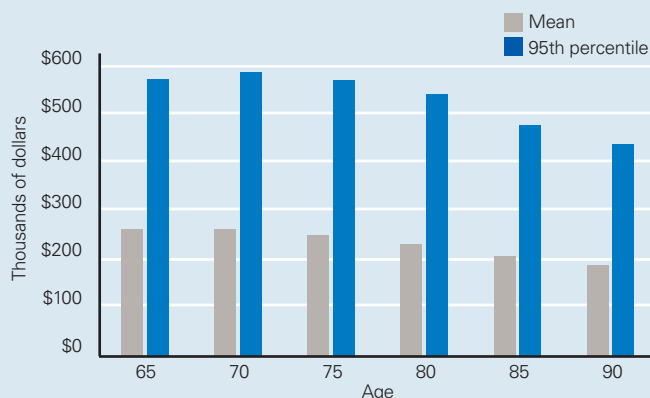


Figure 2. Including Nursing Home Care



Note: In Figures 1 and 2, the first set of bars shows the mean and 95th percentile of lifetime healthcare costs for households from age 65. The second set of bars shows the mean and 95th percentile of remaining lifetime healthcare costs from age 70, discounted back to age 70, for a household in which both husband and wife survive to age 70. Source: Webb and Zhivan (2010).

- Although lifetime healthcare costs decline with age, they remain substantial. At age 85, couples face an average remaining lifetime cost of \$140,000 without nursing home care, and they face a 5% risk of exceeding \$266,000. Home care costs are included in these figures—21% of those 85 and older responded that they had incurred home care costs during the past two years. Including nursing home care, the average cost is \$203,000, with a 5% chance of exceeding \$477,000.

### Implications

The magnitude and distribution of healthcare costs during retirement have implications for individuals, advisors, and employers.

#### Individuals

Out-of-pocket health insurance premiums and healthcare costs will be high for the average household in retirement. Retirees face a risk that these costs could seriously deplete their financial assets. Moreover, households need to assess the possibility that they may incur out-of-pocket healthcare costs that are significantly higher than the average.

- While still in the workplace, individuals can take several proactive steps:
  - Explore current workplace retiree medical insurance coverage and retirement medical savings accounts, if any are available.

- Consider working as long as possible—both to cover any gaps in insurance coverage before reaching Medicare eligibility and to continue accumulating savings for healthcare expenses in retirement.
- Consider long-term care insurance to manage potentially extensive long-term care costs. This coverage is more affordable and generally available with limited or no medical underwriting when purchased while still employed.
- When approaching retirement, individuals should consider taking the following actions:
  - Identify sources of retirement income and establish a budget for how to spend down assets and how much to set aside to cover healthcare costs.
  - Seek solutions that provide guaranteed income while providing some access to assets in the event of health or other emergencies. Explore the usage of variable annuities with:
    - Guaranteed withdrawal benefits, which provide income for life while still allowing access to underlying assets.
    - Accelerated income benefits, which can provide additional income whether an individual is living at home or in a nursing facility.
  - Consider obtaining Medigap coverage to manage uncovered expenses.

## Advisors

Advisors have the opportunity to help clients assess their risks based on their personal situation—rather than on averages—and construct a plan on how to manage these risks. The plan should take a holistic approach and incorporate the presence of healthcare risk when considering retirement income and asset decumulation strategies. Advisors should:

- Work with clients to identify assets that could be used to fund healthcare costs as they arise.
- Explore how annuities (with guaranteed income and accelerated income benefits), long-term care insurance, and other insurance coverage could help fund unusually high healthcare costs.
- Revisit clients' financial plans periodically, as circumstances and health status change.

## Employers

Employers can help employees secure their retirements by taking the following steps:

- Reinforce the need to save robustly for retirement, even if a defined benefit plan is still offered, because retirement assets may be needed to fund healthcare costs.
- Within defined contribution plans:
  - Adopt plan features that encourage participation and adequate saving, such as automatic enrollment and contribution escalation.
  - Provide investments with guarantees to protect future income.
  - Provide distribution options that allow for guaranteed income for life and access to underlying assets, which may be needed to cover high healthcare costs.
- Consider providing voluntary benefits, such as long-term care insurance.

Annuity contracts contain exclusions, limitations, reductions of benefits and terms for keeping them in force.

**Investors should consider the contract and the underlying portfolios' investment objectives, risks, and charges and expenses carefully before investing. This and other important information are in the prospectuses. You should read the prospectuses carefully before investing.**

Variable annuities are appropriate for long-term investing and designed for retirement purposes. Investment return and principal value of an investment will fluctuate so that an investor's unit values, when redeemed, may be worth more or less than their original cost. Withdrawals or surrenders may be subject to contingent deferred sales charges (CDSC). Withdrawals and distributions of taxable amounts are subject to ordinary income tax and, if made prior to age 59 ½, may be subject to an additional 10% federal income tax penalty. Withdrawals, for tax purposes, are deemed to be gains out first. Withdrawals reduce the living benefit, death benefit and account value.

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<sup>1</sup> Prudential Financial supported the Center for Retirement Research at Boston College (CRR) in conducting this research on the distribution of lifetime healthcare costs. The findings and conclusions of the research are solely those of the authors and do not represent the opinions or policy of the CRR or Prudential Financial.

<sup>2</sup> The *Health and Retirement Study* is a nationally representative panel of 12,652 individuals age 51 to 61 in 1992 or married to an age-eligible individual who have been re-interviewed every two years up to and including 2006.

<sup>3</sup> CRR calculation from U.S. Board of Governors of the Federal Reserve System, *Survey of Consumer Finances*, 2007.

<sup>4</sup> Assisted living costs are not included in this analysis.

<sup>5</sup> Prudential Financial, "Long-Term Care Cost Study, 2008," p. 4.

<sup>6</sup> CRR based on Spillman and Lubitz (2002) and Congressional Budget Office (2004).