

# How to think about health care costs in retirement

**Olly Ludwig:** Given that baby boomers have started to retire and that the ranks of U.S. retirees will swell over the next few decades, now's the perfect time to talk about the costs of health care in retirement.

Today we'll dig into a recent research paper on that topic jointly produced by Vanguard and Mercer Health and Benefits.

Our guest is one of the authors of that paper, which is called *Planning for health care costs in retirement*, and he'll help us unpack this complex and sometimes anxiety-provoking subject.

Welcome to Vanguard's Investment Commentary podcast series. I'm Olly Ludwig, and in this month's episode, which we're taping on July 17, 2018, we'll examine clearheaded ways to come to grips with the challenges of planning for health care costs in retirement.

Stephen Weber, an analyst at Vanguard's U.S. Wealth Planning Research Group, is here to guide us and help advisors and investors think clearly about this very complex landscape. Stephen, thanks for joining us today.

**Stephen Weber:** Good to be here.

**Olly Ludwig:** I read your paper and then I read it again, and it's extremely informative, Stephen. But I have to say, both times I read it I was battling my own anxiety, and I even felt a little avoidant at times. But I'm guessing I'm hardly alone in finding this topic daunting, right?

**Stephen Weber:** Absolutely not. Everybody who comes to this topic brings their own experience to it. One of the things I took away from it was how much I was learning about my personal situation as we were going through it. It's not really just a topic that we talk about sort of academically to deal with clients. It's something that each of us individually deals with thinking about in our own right, so . . .

**Olly Ludwig:** Interesting.

**Stephen Weber:** You're not the first.

**Olly Ludwig:** So what is Vanguard saying in this paper that advisors and investors might not hear elsewhere?

**Stephen Weber:** We took a slightly different approach to thinking about this problem in that we're trying to pull back a little bit from the fear that is often surrounding this subject. Advisors often, when we talk about health care in retirement, seem to go to two things. They either go to HSAs [health savings accounts] or they go to long-term care insurance—like this is the framework for health care costs in retirement because there are products associated with those types of things, and they're used to talking about product solutions to problems.

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## Meet the speaker



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But we wanted to take a little bit of a further step back and think about retirement in the broader sense—that it's not really just a wealth problem, it's a health and wealth problem. And if we can give a framework for people to think about the issues that they're going to face about health care and paying for health care during retirement, that's probably a better approach than trying to focus on product solutions.

**Olly Ludwig:** A key idea in the paper is that it's important to look at the costs of health care in retirement not as one huge figure but a discrete annualized nut. Can you speak to that?

**Stephen Weber:** Right. That's one of the big things that we came to this with. When we look out in the world—both in academic sources but also in popular sources—any time somebody seems to talk about health care in retirement, they talk about some really large number—\$250,000 or more that it's going to cost just to pay for normal health care expenses in retirement. And we call these big, scary numbers, right? Because they are big and scary.

But the reality is, nobody talks with you about your food that way; nobody talks to you about other things that you spend on a year-to-year basis that way. A 65-year-old couple could expect to live 27 years, on average, at the joint life expectancy. You take any number and multiply it by 27 years, it's going to become a big number.

**Olly Ludwig:** Yeah. Well, we're going to play a game here: I'm going to tell you how anxious I am, and you're going to talk me off the edge. Here's the next one: As people grow older, health care costs go up, and sometimes it goes parabolic right before death. Help me see through this anxiety-provoking aspect.

**Stephen Weber:** Well, it is a real thing. Health care cost growth is a big deal. As we age, we consume more health care. So a 65-year-old person is going to consume more than a 45-year-old person, and an 85-year-old person is going to use more health care than a 65-year-old person. I look at my parents, and they each take a handful of pills every day. I know that, inevitably, I'm going to have my own handful of pills. That's coupled with the fact that [the cost of] health care tends to grow a little faster than inflation. So this creates a bit of a scary situation. You see that you're going to hit retirement, and you're going to have this cost that's going to just keep growing and growing on you.

We actually don't think, though, that that's a big deal from a planning perspective. And the reason for that is, in general, when we plan for retirement costs, we assume that people are going to spend a fairly consistent amount as they go through retirement, growing maybe at a rate of inflation. But the things that we spend on other than health care go down more than the amount that we spend on health care. So . . .

**Olly Ludwig:** Travel, entertainment, food? What are we talking about?

**Stephen Weber:** All that kind of stuff, right? So I think about my parents, who are in their late 70s, and they take a handful of pills, but they don't drive as much as they used to. It's hard to find something to buy them for Christmas because they already have everything they want. They're more interested in giving me all their stuff than they are in getting new stuff.

**Olly Ludwig:** That's a good thing. One of the things that really seems very anxiety-provoking is that you're working one day, and then you're not working the next day. And on that next day, everything changes. A whole new universe of contingencies comes into focus. Medicare, for example: all these—A, C, D—all the different Medicares. It's like, "Wow!" This is just an alphabet soup of anxiety. It's a scary transition, it appears to me.

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**Stephen Weber:** It is a little scary, and it is probably the bigger issue when we're talking about normal health care costs as we hit retirement. You're probably going to have a jump in your cost of that. It's not the same as food. What you spend on food the day before you retire and what you spend on food the day after you retire is pretty much the same. Health care is not going to be the same.

So a good thing for planning, from a planning perspective, is to sort of work on getting your arms around the Medicare alphabet soup and understanding what your costs are going to be in the area that you live for those types of things.

**Olly Ludwig:** Yeah, I was going to ask you about that. If I live in Pennsylvania or California or Idaho or Florida—could be different, yes?

**Stephen Weber:** It can be. Medicare B premiums aren't going to change based on where you live; they might change on your income. But the private insurance that complements Medicare insurance, like supplemental Medigap, can change in terms of the cost for those premiums. Also, the cost of services can be different. The cost of what you might pay in Manhattan is not necessarily the same as Montana. So there are some geographical differences associated with those costs.

There are other differences that probably make more of a factor when you're thinking about what the change in your health care cost is going to be. A big one is your health status. If you're sick, you're going to have a bit more out-of-pocket cost. It's also going to matter in terms of the coverage choices that you make. So the more comprehensive policies that you pick, you're going to have higher premiums, but potentially lower out-of-pocket costs. But healthier people might prefer to have a lower-premium type of insurance with a possibly higher out-of-pocket cost.

They're not that different than the choices that we make as workers and we're choosing between different plans that our employers might offer. But the difference is, you need to find out what these things are going to cost in your situation.

**Olly Ludwig:** Right. One of the things that I thought was very interesting about the paper: You treat long-term care differently, distinctly, and that seems like a sensible way to approach the whole matter. It's a whole different topic, and a whole different universe of anxiety.

I have a 92-year-old mother who's now in a memory care unit, and so I live it personally in some sense and think, "Good grief, what's going to happen when it's my turn?" That said, what are the key takeaways when investors and advisors think about long-term care and the various and sundry challenges that exist in that whole world of possibilities?

**Stephen Weber:** I agree, this is really the elephant in the room. While people say they're worried about their health care costs, I don't really think they're all that worried about paying their Medicare premiums year to year. But there is this worry, and most of it is associated with long-term care, which is this big, nebulous cost that not only is perceived as very expensive, but it comes with it this sort of debilitating medical circumstance—nobody wants to be a burden. All these things come into play.

The big takeaway that we had around long-term care is that, first of all, most people are not going to need to pay for long-term care. Only about half of people are going to need to pay anything for long-term care.

**Olly Ludwig:** Half, you said?

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**Stephen Weber:** About half will pay something for long-term care. But there is a tail. There is about 15 percent of people that may need to pay a quarter of a million dollars or more. But even knowing that can potentially be a little bit reassuring because the number that most of us carry around in our head is the worst example that we know from our lives. So the aunt that spent ten years in an expensive nursing home is everybody's sort of baseline.

**Olly Ludwig:** And she's in that 15 percent cohort you just touched on a moment ago, I presume.

**Stephen Weber:** Right. And she's not only in that 15 percent cohort; she's like the 15 percent of the 15 percent. That's kind of what we all carry around in our mind—this kind of worst-case example that we know. But part of what we were just trying to do here is help people get a framework of what things actually might cost and their likelihoods for dealing with these costs.

**Olly Ludwig:** You definitely downplay long-term care insurance in the paper, which I thought was interesting. Can you explain that?

**Stephen Weber:** Yeah, we downplayed long-term care insurance not because we think negative things about long-term care insurance, but just because when you look at how long-term care actually gets paid for in the United States, long-term care insurance is really a very minor player.

Only about 8 percent of people that end up paying for long-term care, and have any long-term care paid for, are using long-term care insurance to pay it. And it only pays about 3 percent of the total cost of long-term care. The majority of what gets paid for in the United States comes from you and me: It comes out of pocket. The rest of what gets paid for tends to come through public-financing programs—Medicare pays a little bit for a lot of people, and then, for people that don't have money, Medicaid is sort of the backstop.

**Olly Ludwig:** Right. Medicaid would be like the doomsday scenario. There is a societal backstop for those who are in that really unfortunate situation.

**Stephen Weber:** It's not always necessarily a doomsday scenario, but when you think about it from a planning perspective, for people that are retirees with wealth that want to do many things with their money, including have bequests and things like that, those plans are kind of out the window if you're in a Medicaid scenario.

**Olly Ludwig:** Let's take a step back to long-term care insurance. If it's a small piece of the overall pie and most people aren't going to pay long-term care insurance, essentially—that's what you said, right?

**Stephen Weber:** Uh-huh.

**Olly Ludwig:** Is it a responsibility of advisors and should investors be thinking about this discrete bucket as they plan, as they invest in their strategy, so they integrate a long-term care piece to it?

**Stephen Weber:** It is incumbent, I guess you would say, on advisors to be helping clients think about what the scenario is going to look like for them. So it's also important to realize we've been talking about paid long-term care. A lot of long-term care in the United States is actually unpaid care.

So, for example, my mother-in-law had cancer and lived with us for a couple of years. And she wouldn't show up in the paid long-term care stats at all.

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**Olly Ludwig:** I was thinking out loud or to myself: Family love is a piece of this puzzle. Whether it's a daughter or a son, or maybe a younger sister of the older person, they may step in and do some serious work that in another context would be quite expensive, yes?

**Stephen Weber:** Right. That's exactly the point. You know, my wife probably spent 20 hours a week, on top of her full-time job, making breakfast, doing all the kinds of things that you need to do in that type of scenario. So a lot of that care is informal.

And the other thing to keep in mind is there's a lot of paid care that's available that's short of full-time, private nursing home care that's the kind of expense that people think about as the crippling expenses. There's things like adult day care that can be available; there's home health aides that may be less expensive; there's assisted living, which is sort of like a light version of a full-time nursing home. There's a lot of stages, potentially, of long-term care that are short of needing 24-hour, round-the-clock nursing home attention—particularly in a private room, right?—which tends to be the scenario where all of our minds go.

**Olly Ludwig:** Got it. Well, one aspect of the long-term care discussion that was interesting to me is that women tend to incur more long-term care costs than men. Can you develop that for a moment, please?

**Stephen Weber:** Women consume more paid long-term care than men, largely because they're less likely to have the kind of informal care that we were talking about before.

So men are more likely to be married as retirees, and a good portion of them probably have younger spouses that will tend to live longer than them anyway just based on normal life expectancy things. So it's more likely that when a man hits a long-term care type of scenario, there's an informal care network in the form of a spouse at least available to help take care of them. Women are less likely to have that.

So when you get to the real tail of the cost that we were talking about—when you look at the time that people spend potentially consuming paid long-term care—if you look at five years or more, it's more likely, almost double the chance—or more than double the chance, actually—that a woman would be in that situation as a man.

**Olly Ludwig:** So in all this that we've been talking about, bring it home. What are the key takeaways?

**Stephen Weber:** I think our key takeaway is, again, that it's all very scary in the sense that health and wealth is a scary thing to talk about. But it's not as scary as it seems. So the monsters under the bed are very scary until you shine a light under it. And part of what we're trying to do is put the light out there to give people a sense of the landscape and understand that it's a type of thing that you can plan for. That you're likely, if you're a fairly affluent retiree, to be able to handle this kind of expense, that there are solutions available to getting to a retirement program that takes your health and your wealth into account at the same time.

**Olly Ludwig:** That's great. Stephen, thanks for sharing your insights and for joining us for this Vanguard Investment Commentary Podcast to discuss your paper *Planning for health care costs in retirement*.

**Stephen Weber:** It was great to be here. Thanks.

**Olly Ludwig:** To read the paper and to learn more about Vanguard's thoughts on various financial planning topics, check out our website. And be sure to check back with us each month for more insights into the markets and investing. Also, remember that you can always follow us on Twitter and LinkedIn. Thanks for listening.

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