Paying For Health Care In Retirement: Workers' Knowledge Of Benefits And Expenses

People's expectations exceed reality when it comes to understanding the availability of resources to pay for health care after they retire.

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ABSTRACT: Anecdotal evidence of retirees returning to the workforce to obtain health coverage has appeared against a backdrop of rising health insurance premiums and cutbacks in employer health benefit offerings to both current and future retirees. We present findings from a survey of workers ages forty-five to sixty-four concerning their attitudes toward and plans for health care coverage and expenses during retirement. We find a mismatch between workers' expectations about the benefits that are likely to be available to them and their planning as to how they will pay for health care in retirement.

NEWSPAPERS AND MAGAZINES HAVE RECENTLY been filled with anecdotes of America's seniors leaving the pleasures of retirement to return to the workforce—primarily, it would seem, to work at fast-food establishments and Wal-Marts. In addition to the depletion of savings as a result of the recent stock market slump, one of the major precipitating factors in the return to work appears to be the unanticipated high cost of health care and lack of third-party coverage. These anecdotes are supported by increasing empirical evidence documenting rising health insurance premiums, increasing financial obligations for retiree health benefits on the part of employers, and resulting cutbacks in employer health benefit offerings to both current and future retirees. The total cost of providing retiree health benefits has been increasing rapidly—for the largest employers, this cost rose approximately 16 percent between 2001 and 2002, continuing apace between 2002 and 2003 to rise another 14 percent.[1]

The growing costs borne by employers has meant that the availability of cover-

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age to retirees has fallen dramatically: In 1988 two-thirds of firms offered retiree health coverage, compared with only 38 percent in 2003.[2] Among firms with fewer than 200 workers, a scant 10 percent offered retiree coverage in 2003. And more than one-fifth of the largest private employers surveyed in 2003 indicated that they were "very or somewhat likely" to end all subsidized health benefits for future retirees; more than 80 percent said they would probably increase employee premium contributions as well as increase employee cost sharing.[3]

Of particular concern, Watson Wyatt Worldwide predicts that by 2031 employers will pay less than 10 percent of total retiree medical costs.[4] Although accumulated savings vary considerably by age and by job tenure, in 2002 the average 401(k) balance for people in their sixties was approximately $107,000.[5] Given that this savings is intended to cover all kinds of retirement expenses, not just health care, the disconnect between savings and predicted health expenses presents a serious problem from both an individual and a public policy perspective.

In this paper we present findings from a survey of workers ages 45–64 concerning their attitudes toward and plans for meeting health care expenses during retirement. Because of a number of features that will directly affect employer-sponsored retiree health benefits, the recent passage of the Medicare Prescription Drug, Improvement, and Modernization Act (MMA) of 2003 may prompt employers to reexamine and, possibly, restructure current benefits, although the effects on the availability of retiree coverage remain unclear. Since our survey was conducted before MMA was passed, responses reported here do not take account of possible reactions to potential changes resulting from its passage.

Study Data And Methods

The survey field work was implemented by Synovate as part of a larger survey asking a core set of demographic questions and then adds additional questions from a number of separate funders. The survey—conducted by telephone during 5–17 September 2003—was administered to 703 respondents ages 45–64 who met one of the following two conditions: (1) They were working at the time of the interview and receiving employer- or union-sponsored health insurance coverage through their job, or (2) their spouse was working at the time of the interview and the respondent received employer- or union-sponsored coverage through their spouse's job. These selection criteria were applied to understand the knowledge and attitudes of workers who were approaching retirement and who had health benefits from an employer. Respondents were asked several questions about the employer from which they obtained coverage. Overall, 35 percent of respondents obtained their health insurance through a local, state, or federal government; one-third worked in firms with fewer than 100 employees, and 41 percent, in firms with 1,000 or more workers; and 16 percent were union members.[6]

Interviews were conducted over a period of several weeks using a single-stage, random-digit-dial sample technique to select the sample from all available resi-

dential telephone numbers in the contiguous United States. Using a methodology similar to political polling, Synovate makes up to three attempts to reach each selected household. The short field period does not allow the achievement of a response rate that would be comparable to those of government-sponsored surveys with field periods of several months. Data are weighted on an individual multidimensional basis to give appropriate representation of the interaction between various demographic factors, including age within income, within the four national census regions, and within gender. The U.S. Census Bureau's Current Population Survey (CPS) is used to determine weighting targets. Estimates discussed below are weighted. Where noted, differences in the distribution of responses are statistically significant using a chi-square test at the .05 level.

Survey Findings: Workers' Plans For Retirement

When people were asked whether they planned to retire before age sixty-five or after they had reached age sixty-five, responses were evenly split, with 47 percent in each category and 5 percent responding that they didn't know. A number of factors contribute to a person's expectation of early retirement, including personal characteristics such as marital or health status as well as economic factors such as the extent of savings and existence or generosity of a pension. Exhibit 1 presents data on how planned retirement age varies with a number of these sociodemographic characteristics. People who were more likely to retire early included those with higher household incomes (more than $75,000 annually), married people, and whites. Workers employed at larger firms and union members were also more likely to say that they would retire before age sixty-five, perhaps because such people may be more likely to have better pension benefits.[7]

Of those who planned to retire before they reach age sixty-five, the vast majority expected to be covered by health insurance until they are eligible for Medicare (Exhibit 2). Almost two-thirds of those planning early retirement reported that they would be covered through their own or their spouse's employer or union. Others planned to purchase a health policy on their own, obtain coverage through provisions of the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1986, or receive some form of public coverage such as Medicaid or the Department of Veterans Affairs (VA).[8]

Eligibility for Medicare is almost universal at age sixty-five, but many Medicare beneficiaries still have supplemental or wraparound benefits to fill in some of the gaps left by Medicare's benefit package. When asked whether such coverage would be available from their employer, more than half of workers surveyed responded that they expected to get such supplemental health insurance through an employer or union; approximately 30 percent said that they did not expect to do so; and 10 percent said that they did not know whether coverage would be available. There was little statistically significant variation in the proportion of people who expected to have employer-sponsored coverage in retirement (Exhibit 3).

EXHIBIT 1
Planned Retirement Age Of Workers Ages 45–64, By Various Worker Characteristics, 2003

	Planning to retire before age 65 (%)	Planning to retire at age 65 or older (%)	Don't know (%)
All	47	47	5
Age (years)			
45–54	49	46	4
55–64	45	48	5
Sex			
Male	45	49	6
Female	50	46	4
Race[a]			
White	49	46	4
Nonwhite	37	56	6
Income[a]			
Less than $25,000	32	61	7
$25,000–$49,999	41	51	6
$50,000–$74,999	39	54	6
$75,000 or more	54	44	2
Marital status[a]			
Married	50	44	5
Not married	40	57	3
Education			
High school or less	44	47	7
Some college	48	48	4
Postgraduate	50	44	4
Union member[a]	62	34	4
Government worker	53	43	3
Firm size (number of workers)[a]			
Fewer than 25	43	50	7
25–199	36	57	6
200 or more	54	43	2

SOURCE: NORC Retiree Health Benefits Survey, September 2003.

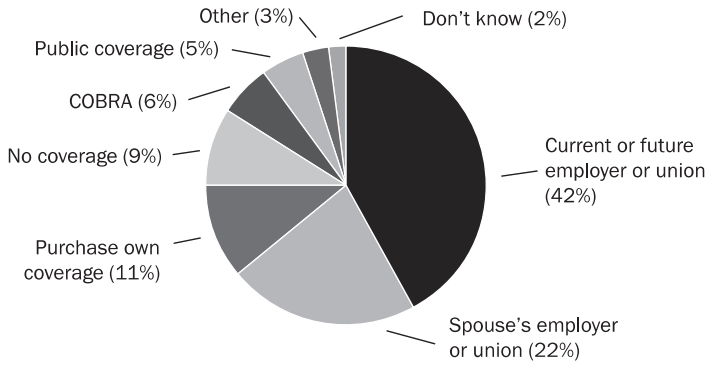
NOTE: Percentages may not add to 100 because of nonresponse.

[a] $p < .05$ for chi-square comparing distributions of planned retirement age responses by age, sex, race, income, marital status, education, union membership, government employment, and firm size.

When asked how much they expected to pay for their retiree health insurance, one-third of respondents said that they could not provide any information about the expected costs.

In terms of people's confidence that they would be able to afford to pay their portion of the premium for this coverage, more than half said that they were extremely or very confident, 30 percent were somewhat confident, and only 16 percent were not too or not at all confident. High-income people, married people, and people with more education were more likely than their counterparts to be extremely or very confident that they would be able to afford the premiums. Even

EXHIBIT 2
Expected Source Of Coverage For Health Benefits Among People Expecting To Retire Before Age 65, 2003



SOURCE: NORC Retiree Health Benefits Survey, September 2003.
NOTE: COBRA is Consolidated Omnibus Budget Reconciliation Act of 1986.

though they were more likely to expect work-related coverage, government workers and union members were not significantly more likely than other workers to feel confident about being able to afford the coverage.

For workers who did not expect to have employer-sponsored retiree health benefits available after age sixty-five, we asked whether they planned to purchase Medicare supplemental (Medigap) coverage on their own. More than two-thirds said that they definitely or probably would purchase such a policy, but only a third of these were extremely or very confident about their ability to afford the associated premiums (Exhibit 4). The level of confidence expressed was lower for those who were not expecting employer-provided coverage than for those who expect to get insurance from their employer or union. A higher proportion of the former group had no knowledge of potential premium costs. When asked how much they expected to pay for their individually purchased Medigap coverage, 40 percent of respondents were unable to provide any information about expected costs. Another 11 percent reported that they did not know whether they would purchase supplemental coverage (data not shown), and 20 percent said that they probably or definitely would not purchase any health insurance beyond Medicare. When this 20 percent of respondents were asked why they would not purchase such coverage, one-fourth responded that they did not know, and one-fourth said that coverage was too expensive (Exhibit 4).

In terms of planning for retirement, only 22 percent of people ages 45–54 and 29 percent of those ages 55–64 said that they had given a lot of thought to how they would pay for health care services not covered by Medicare. Almost half of each group said that they had given the subject a little thought. Thirty percent of the younger cohort and 24 percent of the older group said that they had not thought about it at all. A higher proportion of women than men said that they had thought

EXHIBIT 3
Percentage Of Workers Expecting To Obtain Health Insurance Through Employer Or Union, And Confidence In Ability To Afford Coverage For Retirees Age 65 And Older, 2003

	Percent expecting to obtain coverage through job/union	Level of confidence in affordability (%)		
		Extremely or very confident	Somewhat confident	Not too or not at all confident
All	59	54	30	16
Income[a]				
Less than $25,000	46	44	25	31
$25,000–$49,999	56	39	31	28
$50,000–$74,999	63	41	38	20
$75,000 or more	58	69	24	6
Marital status[a]				
Married	61	56	30	13
Not married	53	49	28	23
Education[a]				
High school or less	60	44	31	22
Some college	61	52	33	14
Postgraduate	54	71	18	11
Union member	66	55	29	15
Government worker[b]	70	59	27	12
Firm size (number of workers)[a]				
Fewer than 25	48	54	19	26
25–199	54	49	30	19
200 or more	66	57	30	12

SOURCE: NORC Retiree Health Benefits Survey, September 2003.
NOTE: Percentages may not add to 100, because a small number of respondents responded "don't know."
[a] $p < .05$ for chi-square comparing distributions of confidence in affordability responses by income, marital status, education, union membership, government employment, and firm size.
[b] $p < .05$ for chi-square comparing distributions of expected coverage by income, marital status, education, union membership, government employment, and firm size.

about the issue a lot, and people with incomes under $25,000 were more likely than those with incomes of $75,000 and higher were to say that they had thought a lot about how to pay these expenses. On the other hand, a higher percentage of nonwhites and people with a high school education or less said that they had given the subject no thought at all.

When assessing workers' knowledge about retiree health benefits, we found that only 28 percent said that they have ever asked employers for or had employers offer them information about the availability of retiree health coverage. Those nearer to retirement (ages 55–64) were slightly more likely (31 percent) than the cohort of younger workers were (25 percent) to have received or asked for such information. Those with higher incomes were also more likely than those with lower incomes to have done so, and people with some postcollege education were the most likely to have asked for or been given information. Even in these groups,

EXHIBIT 4
Likelihood Of Purchase Of Supplemental Coverage And Confidence In Its Affordability, Among People Who Do Not Expect Employer-Sponsored Insurance After They Reach Age 65, 2003

Confidence level/reasons	Percent
Will definitely or probably purchase supplemental coverage	69
Level of confidence in affordability[a]	
Extremely or very confident	33
Somewhat confident	44
Not too or not at all confident	22
Will probably or definitely not purchase supplemental coverage	20
Reason why not	
Medicare is good enough	15
Good health	9
Too costly	26
Other	19
Don't know	26

SOURCE: NORC Retiree Health Benefits Survey, September 2003.
[a] Approximately 1 percent of respondents did not know how confident they were.

however, the proportion remained well under 50 percent.

Only 18 percent of respondents said that in the past three years their employer had told them about any negative changes in the firm's retiree health benefits. This is in marked contrast to the results of a recent survey of large employers, which found that in the past year, 71 percent of employers had increased employees' contribution to retiree coverage, 53 percent had increased general cost sharing for retiree health benefits, and 34 percent had raised deductibles.[9]

Because some workers approaching retirement expect to rely solely on Medicare for their health care expenses, we wanted to find out how much they knew about Medicare's benefit package. We asked about four dimensions of coverage: hospital care, doctor visits, nursing home care for long-term stays, and outpatient prescription drugs. The first two types of services were covered by Medicare at the time of the survey; the second two were not. The question wording included the phrase "as of today" to help avoid confusion given the debate that was then surrounding the addition of an outpatient drug benefit to Medicare.

Roughly half of respondents responded correctly to each individual question—59 percent of workers stated correctly that Medicare covered hospital stays, 54 percent knew that physician visits were a covered service, 52 percent thought that Medicare did not cover long-term nursing home stays, and 47 percent correctly responded that Medicare did not pay for outpatient prescription drugs. There were no discernible patterns in terms of knowledge across population subgroups (the few statistically significant differences involved only one service), which suggests that no groups clearly understood Medicare's coverage. For each service, 23–31 percent of respondents said that they did not know whether the service was cov-

ered. Of particular concern, only 14 percent of all respondents were correct in their knowledge across all four services.

Finally, with respect to paying health care expenses in retirement, only 3 percent of respondents said that they didn't know how they would cover expenses, although 11 percent responded that they didn't expect to have many expenses. Almost half (44 percent) said that they would rely primarily on retirement income, while 35 percent said that their most likely way to pay for expenses was with personal savings. Only 6 percent expected to rely on Medicaid, and less than 1 percent, on children or other family members.

Discussion

Because of rising health care costs, increased longevity, and declining provision of retiree health benefits by employers, future retirees will face higher out-of-pocket health expenses during their retirement years. In this study we found that workers nearing retirement are not well informed about their benefits (either Medicare or employer-related), nor are they well prepared for meeting their health expenses. It is difficult to predict precisely what benefits will be provided to future retirees because of ongoing cutbacks. However, we find a serious mismatch between what workers are expecting and what they are likely to have available to them. General Accounting Office (GAO) calculations of CPS data indicate that 57 percent of retirees ages 55–64 and 32 percent of retirees age 65 and older received employer-sponsored retiree coverage in 1999.[10] Given that the likelihood of obtaining such coverage has fallen since 1999, our findings that 64 percent of the former group and 59 percent of the latter expect to get these benefits indicate that expectations are out of alignment. As an added caution, our survey respondents were workers with current employer-sponsored health insurance, so they represent people in somewhat better circumstances vis-à-vis paying for health care than workers as a whole.

Our findings concerning the mismatch between expectations and reality are consistent with those of the 2004 Retirement Confidence Survey.[11] In that survey, two-thirds of workers said that they were very or somewhat confident about having enough money to live comfortably in retirement. At the same time, however, the survey found that fewer than half had tried to estimate the level of resources needed in retirement, and, among those who had, many did not remember the results of their calculations or reported that the amount they needed was out of line with their income. Another survey, conducted in the summer of 2003, found that two-thirds of nonretired Americans surveyed said that good retirement benefits were "very important" in thinking about taking a new job.[12] At least on its face, this seems inconsistent with our finding that few workers have inquired about retiree benefits in their existing jobs; however, it fits with the general disagreement we observe between workers' professed actions and expectations and what they will actually face in retirement. The lack of knowledge about Medicare benefits

"Policy options that turn taxable income into a tax-free health benefit may have the most chance of success."

that we found is similar to recent results of a Henry J. Kaiser Family Foundation poll indicating that just under one-third of U.S. adults were even aware that the Medicare reform legislation had been passed by Congress and signed into law.[13]

■ **Effects of MMA.** It may be useful to consider our findings in light of this recent legislation. In addition to adding drug coverage to Medicare's benefit package, MMA includes two additional changes that are of particular importance to retiree health. The first (effective in 2006) is the availability of a tax-free subsidy to employers that continue to provide retiree prescription drug benefits. In the aggregate, the Congressional Budget Office (CBO) has estimated that payments to employers and unions under this provision would amount to $71 billion.[14] At the firm level, the amount of the subsidy is 28 percent of actual costs between $250 and $5,000 per participant (up to $1,330 per person). This subsidy would be available to employers if the retiree health plan they offer provides prescription drug coverage to Medicare-eligible retirees who would be eligible to enroll in Medicare's prescription drug program but decline to do so, with the proviso that the plan be "actuarially equivalent" to Medicare's benefit.[15] However, it is not clear how much flexibility there will be in terms of defining what constitutes a "conforming" plan; because of this uncertainty about what plans will qualify for the subsidy, it is difficult to predict the level of participation by employers and, therefore, the impact on the availability of retiree health benefits.

The second change of potential significance is the ability to offer tax-favored health savings accounts (HSAs). These accounts are similar to medical savings accounts (MSAs) in that they must be linked to a high-deductible health plan, but their availability is being extended beyond small employers and the self-employed. Because no taxes are levied on money going into or out of the accounts and funds can be rolled over from one year to the next, HSAs offer a means for employers to assist or encourage employees to accumulate funds to pay for medical expenses in retirement.[16] The requirement that HSAs be used in conjunction with a high-deductible plan may limit their widespread acceptance, although the evidence of the MSA demonstration is not fully applicable.[17] It is also not clear to what extent limits on contributions would affect the ability to accumulate sizable resources in the accounts.

The legislation will also affect the Medigap market. It prohibits the new purchase of any of the three current Medigap products that include prescription drug coverage and also precludes development of new products that would provide drug benefits. Thus, it is not clear what options will be available to retirees who do not have access to employer-sponsored coverage.

■ **Policy options.** From a policy perspective, then, we are faced with inadequate

savings, rising retiree health care obligations, and a false sense of confidence among workers who are nearing retirement. Extracting more savings out of workers' current income is always difficult, so policy options that turn taxable income into a tax-free health benefit may have the most chance of success. There is also some advantage to employer-based initiatives, because that is the way that health benefits are most commonly provided to workers. There are, of course, a range of policy options to be considered; one employer-based initiative worthy of attention is the expanded use of automatic enrollment in 401(k) plans. Although these plans are general savings vehicles and not specific to health care expenses, we assume that if retirees have more savings overall, they will be more likely to have the resources to cover health care costs. By implementing a system of automatic payroll deductions for 401(k) accounts, employers can greatly increase the proportion of workers who are saving for retirement.[18] What is particularly appealing about this strategy is that payroll withholding is already almost universal, and no new legislation is needed to implement an automatic system. Also, it would be a voluntary program for employers, requiring few resources from them.[19]

Until some action is taken, there is likely to be growing concern as employers continue on the current path of cutbacks in retiree health benefits, especially if we see continued medical care and premium inflation. Our findings that workers nearing retirement are not adequately prepared to face their health care needs present an opportunity for educational efforts on the part of government and employers. The Centers for Medicare and Medicaid Services (CMS) devotes considerable effort to educating current beneficiaries, but such efforts may need to start sooner, before people are eligible for Medicare and retiree plans, so that planning for that stage occurs in time. There is an opportunity for employers as well to step in and mitigate the problem. In particular, employers could take responsibility for educating employees about what faces them—how likely they are to get benefits, how much health care will cost them, how Medicare benefits will help them, and what will not be covered. For retirees to be better prepared to meet future obligations, increased awareness on the part of workers needs to be coupled with private or public policy initiatives that will encourage saving.

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NOTES

1. Hewitt Associates and the Henry J. Kaiser Family Foundation, *The Current State of Retiree Health Benefits: Findings from the Kaiser/Hewitt 2002 Retiree Health Survey* (Washington: Kaiser Family Foundation, 5 December 2002); and F.B. McArdle et al., "Large Firms' Retiree Health Benefits before Medicare Reform: 2003 Survey Results," *Health Affairs*, 14 January 2004, content.healthaffairs.org/cgi/content/abstract/hlthaff.w4.7 (22 March 2004).
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4. Watson Wyatt Worldwide, "Retiree Health Benefits: Time to Resuscitate? Executive Summary," 2004, www.watsonwyatt.com/research/resrender.asp?id=W-559&page=1 (4 June 2004).
5. S. Holden and J. VanDerhei, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2002," *Investment Company Institute Perspective* 9, no. 5, September 2003, www.ici.org/stats/res/per09-05.pdf (26 February 2004).
6. A copy of the survey is available on request; e-mail Claudia Schur at schur-claudia@norc.net.
7. The ability to collect pension benefits may depend not only on age at retirement but also on the number of years of employment with a given employer, so specific plans and expectations of individual workers may be difficult to interpret.
8. While COBRA benefits last only eighteen months, an analysis of retirees pre- and post-COBRA enactment found that early retirees after 1986 were less likely than early retirees prior to 1986 were to become uninsured. L. Karoly and J. Rogowski, "Effects of Access to Post-Retirement Health Insurance on Retirement Behavior and Insurance Coverage," *RAND Health Research Highlights*, 1998, www.rand.org/publications/RB/RB4507-1 (24 June 2004).
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13. Henry J. Kaiser Family Foundation, "March/April 2004 Kaiser Health Poll Report Survey—Selected Findings on the Knowledge and Understanding of the New Medicare Rx Drug Program (Toplines)," April 2004, www.kff.org/kaiserpolls/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=34326 (31 May 2004).
14. CBO Testimony, statement of Douglas Holtz-Eakin, director, "Estimating the Cost of the Medicare Modernization Act," before the Committee on Ways and Means, U.S. House of Representatives, 24 March 2004, www.cbo.gov/showdoc.cfm?index=5252&sequence=0 (5 April 2004).
15. Another consideration is that if an employer supplements its prescription drug benefit, then the employer subsidy could be decreased based on the decrease in out-of-pocket costs.
16. Employer contributions to the HSA are excluded from employee gross income for federal income tax purposes (this includes employee pretax payroll deductions through a cafeteria plan, which are considered employer contributions for tax purposes) and from wages for employment tax purposes, which creates FICA tax savings for employers. Individual contributions not through a cafeteria plan are deductible in determining gross income.
17. In the MSA demonstration, which took place in the late 1990s, these high-deductible plans were neither widely offered nor widely subscribed. However, there were a number of difficulties in the demonstration design that may have presented barriers to insurers and consumers alike. Among these were the limited duration of the demonstration, which reduced financial incentives for product development on the part of insurers; the limited pool of eligibles; and the complexity of the product, which contributed to the difficulty insurance agents faced in marketing these policies.
18. J.J. Choi et al., "For Better or for Worse: Default Effects and 401(k) Savings Behavior," NBER Working Paper no. 8651 (Cambridge, Mass.: National Bureau of Economic Research, 2001); and B. Madrian and D.F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116, no. 4 (2001): 1149–1187.
19. One of the limitations that has been noted in the literature is that workers who are automatically enrolled tend to stick with low default contribution rates and conservative default investments. These problems could be remedied, however, through an accelerated system of contribution rates, wherein the default rate increases with time in the plan and the default investment is a mixed portfolio.