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Funding Retiree Medical & Long-Term Care for the Second Half of the 21st Century

Solution: Make available and leverage all tax preferred savings options … then … save all you can!

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The year 2050! It is less than 30 years away. In America, "People have within their own hands the tools to fashion their own destiny."[1] However, most employers and employees have yet to pick up the tools that are best suited for funding post-employment medical coverage (retiree medical) and long-term care (LTC) costs—regardless of residential or custodial setting.[2]

As the most valuable tax preference in America's Internal Revenue Code (IRC), the Health Savings Account (HSA) offers both employers and employees a tax-preferred funding solution.[3] The HSA is capable of "quadruple duty"—medical and LTC expenses/insurance premium **before** retirement, retiree medical and LTC, including "medical accessibility" expenses **during** retirement, provision of income after age 65, and legacy/survivor benefits. Unfortunately, 16 years after HSAs were added to the tax code,[4] less than 25 percent of employers offer HSA-capable coverage.[5] Worse, most offers of HSA-capable coverage intentionally or unintentionally discourage participation. Even worse, perhaps 95+ percent of workers who elect HSA-capable coverage have not accumulated and invested any savings.[6] And, amazingly, the most recent report to Congress on retirement preparation decision-making does not even mention Health Savings Accounts.[7] Without change, most workers (today and tomorrow) will arrive at retirement without any tax-preferred assets specifically earmarked for retiree medical and LTC needs.

We don't need an actuary to identify the risk exposure. For most workers, it exceeds their capability to save (See Sidebar #1: The Need). The need may also exceed the maximum tax-preferred funding. So, there is no doubt about needed action: **Make available and leverage all tax-preferred savings options … then … save all you can!**

WHO PAYS, HOW MUCH?

As Yogi Berra famously said, "It's tough to make predictions, especially about the future." Or, "the future ain't what it used to be." However, our future, at least when it comes to retiree medical and LTC seems crystal clear. Few workers and their employers prioritize this risk exposure. Even fewer are willing to forego current spending to fund these future needs. Few employers offer retiree medical coverage. Even fewer offer access to LTC. Even where retiree medical still exists, most private sector employers have limited access and coverage to

SIDEBAR #1: THE NEED

Estimates suggest a retired couple, both age 65 today, would need ~$325,000 to have a 90 percent chance to fully fund retiree medical costs. At the 90th percentile, should both enter a nursing home, add in another ~$364,000 for LTC expenses. For comparison, median net worth of American households where the head of household is age 55–64 is $187,000 ($224,000, age 65–74; $265,000 age 75+).[35]

Annual retiree medical expense at the median, the 50th percentile, is a more modest $6,300/year (Note: Medians exclude LTC care expenses because less than half of today's retirees incur those expenses.)[36] One estimate notes that by 2030, one in five Americans will be age 65+, and, at some point in their lives, 70 percent of those age 65+ will need Long Term Services and Support (LTSS). Individuals and families pay 52 percent of LTC costs out of pocket. Medicaid pays for nearly 34 percent of LTC costs, primarily for low-income people or those who have spent down their financial assets to qualify for coverage. Private LTC insurance pays less than 3 percent.[37]

Solution: Save all you can, leverage any and every available tax-preferred savings option. That would be the heuristic, even if we didn't suffer from significant, perhaps unsustainable coverage commitments, such as:

1. A Medicare hospitalization trust fund that is expected to be exhausted prior to 2026.[38]
2. Medicare Part B and D costs which are funded mostly by general revenue (income taxes). As the last of the baby boom generation ages into Medicare, enrollment will spike concurrent with $1+ trillion federal deficits over the next 10 years, projected to add $13.091 trillion to the national debt (fiscal years 2021–2030).[39]
3. Enrollment in taxpayer financed public exchange and Medicaid coverage may also increase significantly:[40]
    - Due to COVID-19, 12.7 million are estimated to become eligible for Medicaid, adding to the 75+ million who were covered by Medicaid in 2019 (while dual-eligibles increase as baby boomers age-in); and
    - another 8.4 million are estimated to enroll in the public exchange marketplace, a doubling of those enrolled in taxpayer-subsidized medical coverage.

By 2030, 20 years before we start the 2nd half of the 21st Century, fewer Americans may be covered by employer-sponsored plans compared to the number enrolled in Medicare, Medicaid and the public exchange

a grandfathered group while concurrently curtailing employer financial support.[8] Simply, most private sector workers never had retiree medical coverage and most never will.

Public employee retiree medical coverage is much more common, however, unfunded. State retiree medical unfunded liabilities exceed $700 billion; and unfunded retiree medical is 40+ percent of the debt held by America's largest cities.[9] Unlike private sector employers, public employers continue to offer the coverage, some have enhanced it even as liabilities grow. Most state and local leaders will require future taxpayers, many not old enough to vote and/or generations yet unborn, to pay for today's unfunded, public employee pension and retiree medical promises.

Our entitlement systems, Medicare, Medicaid and public exchange coverage, also present looming liabilities.[10] Today's federal leaders have discussed this challenge, on and off, for nearly three decades without action—except to improve benefits that increased taxpayer liability. Congress has yet to address the challenge.[11]

Others proposed further enhancements. Our experience with Health Reform's CLASS coverage is one example.[12] Unlike Medicare Part D prescription drug coverage,[13] which did not include a specific source of funding and added $10+ trillion of unfunded liability, CLASS was added as a program whose premiums were statutorily required to be sufficient for the program to remain fiscally solvent over a 75-year period.[14] CLASS was intended to:

- Be an employer-mandate, with automatic enrollment features;
- be 100 percent employee-paid, with an opt out option;
- cover nursing home and assisted living care, as well as home modifications that would enable seniors to remain at home, as well as cash payments for personal care and transportation assistance;
- offer a $50 per day benefit;
- limit benefits to those who had paid into the program for at least five years;
- limit benefits to those who required assistance with two or more Activities of Daily Living; and
- require premiums ranging from $5/month for those living below the poverty line, $125/month for middle-aged individuals with average household income of approximately $50,000/year, and more for those with higher incomes.

SIDEBAR #2: CONGRESS GIVETH AND TAKETH AWAY

Giveth: We've seen positive changes that help workers prepare for retiree medical and LTC needs:

- LTC out-of-pocket expenses are now treated much the same as IRC §213(d) medical expenses;
- more home equity and reverse mortgage alternatives are in place, but perhaps not so much more given the relative increased cost of providing custodial care;
- new tax-favored funding of LTC insurance[41] and LTC out-of-pocket costs using HSA assets;[42] and
- annuities and life insurance with LTC riders.[43]

And, we've seen some take-aways, too:

- Curtailed tax-favored funding (IRC §419, IRC §501(c)(9));[44]
- curtailed deferrals under IRC §125 to fund out-of-pocket expenses;[45]
- failure to update IRC §401(h) since adoption in 1962 despite the prevalence of 401(k) and 403(b) plans;[46]
- curtailment of most private sector, non-represented employee retiree medical;[47] and
- curtailment of affordable LTC insurance offerings—they came, then mostly disappeared.[48]

However, once government actuaries estimated premiums for the proposed coverage would be $235 to $391 per month, a price few Americans would be willing to pay, Congress rescinded this voluntary program.[15] Many other actions confirm Congress' inconsistency when it comes to encouraging workers to save for future medical and LTC costs. (See Sidebar #2: Congress Giveth and Taketh Away)

Too many American workers already live paycheck to paycheck—where even a one-week delay in their next paycheck would cause 70+ percent of survey respondents "some or significant difficulty."[16] So, how can we ask workers to fund retiree medical and LTC by diverting an already modest level of savings[17] given:

- A substantial portion of eligible workers don't participate in their employer's 401(k) plan (24 percent);[18]
- of the workers who do participate in 401(k) plans, a substantial portion don't save enough to receive the full employer financial support (34 percent);[19]
- all wage earners are eligible for an IRA, but only 12 percent of eligible households contributed in 2018;[20]
- few eligible for a 401(k) or 403(b) max out their contributions;[21]
- many employer-sponsored plans don't offer catch-up contributions (23.6 percent);[22]
- only 15 percent of employees eligible for catch-up made those contributions in 2019;[23]
- most employer-sponsored retirement savings plans don't offer 401(a) after-tax contributions (81 percent);[24]
- only 8 percent of employees eligible for after-tax contributions made those contributions in 2019;[25]
- only a handful of employer-sponsored retirement savings plans offer Deemed IRAs (< 1 percent);
- median tenure continues to be less than five years,[26] while 36 percent of terminating participants cashed out when changing jobs;[27]
- a sizeable minority of households have no emergency assets;[28] and
- Congress repeatedly encourages pre-retirement distributions, leakage, by liberalizing withdrawal rules—most recently the Bipartisan Budget Act of 2018, SECURE and CARES.[29]

TAX FAVORED FUNDING SOLUTIONS—CURRENTLY AVAILABLE[30]

Current code and regulatory guidance offer plan sponsors favorable funding options and processes, including:

- For those who already offer retiree medical coverage, ensure it is sustainable and redesigned to encourage saving;[31]
- for those who do not currently offer retiree medical, make available retiree-pay-all, fully insured, employer-sponsored Medicare Supplement and/or Medicare Advantage options through a private exchange;[32]
- for those who offer HSA-capable coverage, ensure designs reflect "best practices" that encourage selection of that coverage option, as well as enrollment, savings and investments in the HSA;[33]
- for employers who offer retirement savings plans, or pension plans, ensure designs and processes encourage workers to save more than they believe they can afford to earmark for a future, uncertain retirement, change from saving for retirement to saving along the way to retirement–providing liquidity without leakage:[34]

SIDEBAR #3: FUNDING SOLUTIONS—MINOR, LOW COST CHANGES THAT WOULD ADD SIGNIFICANT VALUE

"The best way to predict the future is to invent it."[49] However, let's start with inventions that tweak existing, related code and regulatory guidance to expand options to save and flexibility in how savings are used, including:

- **Encourage Savings—Reduce Leakage:** A significant portion of retirement savings are leaked prior to retirement. At the same time, in-service limits and penalty taxes on liquidity often discourage savings.
  - » **Solution:** Allow amendments to retirement savings plans that would prospectively eliminate or limit pre-retirement distribution provisions (without applying IRC §411(d)(6) anti-cutback rules).
  - » **Solution:** Increase the $50,000 plan loan limit for the first time in 45+ years to its current day equivalent (~$250,000, author's calculations) so a retirement savings plan can be promoted to/as a ubiquitous, comprehensive, lifetime savings vehicle (for comparison, in 1976, the average assets/participant in a defined contribution plan were $6,431).[50]
  - » **Solution:** Permit loans from Individual Retirement Accounts (IRAs).
  - » **Solution:** Eliminate penalty-tax-free qualified plan and IRA distributions, except for death and disability.
  - » **Solution:** 401(h) for 401(k)—Extend IRC §401(h) to profit sharing plans to trigger "stretch" match designs.

- **Ubiquitous HSA:** Among covered workers with a general annual deductible, the average deductible amount for single coverage is $1,655 ($2,271 among small firms vs. $1,412 among firms with 200 or more workers).[51] So, many, perhaps most plans use a deductible that exceeds the HSA-capable coverage minimum—$1,400.
  - » **Solution:** Allow "bronze" level coverage (point of purchase cost sharing of 70 percent/30 percent) as HSA-capable coverage — deductibles need not apply to primary services, maintenance Rx, telehealth visits.[52]
  - » **Solution:** Allow insurance companies to offer Medicare Advantage options that are HSA-capable.
  - » **Solution:** Allow Medicare Advantage coverage expansion to include LTSS.
  - » **Solution:** Clarify use of automatic features, extend qualified plan QDIA provisions to HSA investments.

- **Expand Uses:** Existing code/regulations limit a participant's flexibility in using tax-favored plan assets.
  - » **Solution:** IRC §401(a)(13) assignment and alienation provisions allow for a "voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan" Confirm participants can assign or forego benefits to the plan in exchange for an equal amount of employer financial support towards the cost of retiree medical coverage.
  - » **Solution:** Clarify Deemed Roth IRA regulations[53] so participants can fashion longevity risk solutions - qualified plans could aggregate/consolidate retirement savings, plan sponsors could offer annuities without triggering fiduciary responsibilities and participants could apply the same investment choices to assets held in Deemed Roth IRAs without subjecting them to minimum required distributions.,
  - » **Solution:** Clarify and publicize the IRC §152 definition of tax "dependent" and confirm it may include a parent or older household member with respect to qualifying dependent day care/custodial expenses under IRC §129 as well as qualifying medical expenses under IRC §213, where older household members meet "relative" and "support" requirements.
  - » **Solution:** Expand the definition of disability for insurance policies that allow for continued accruals in 401(k) plans to include those unable to perform activities of daily living.[54]

- Eliminate or curtail in-service, hardship and pre-retirement, post-separation withdrawals;
- adopt electronic banking, so loans can not only be repaid after separation but also initiated after separation (to minimize leakage—at separation and among term-vested and retired participants);
- change loan processing to a line-of-credit basis, so participants can confidently access funds while borrowing only what they need (emergencies, planned purchases, etc.) and only when they need it;
- create a commitment bond so that individuals must agree in writing to repay the loan and acknowledge that they are both the borrower and the lender, and that the lender is their future self.

Workers who save today just might be able to prepare for a median level of retiree medical and LTC expense in the 2nd half of the 21st Century.

Finally, don't forget to tout the unique capabilities of HSAs. Your plan sponsor clients might be persuaded to make a HSA-capable health option and HSA available if you explain how the HSA can enable a legacy, serve as an anti-selection sentinel, offer a one-time funding opportunity (the last month rule), provide executive benefits, offer income tax averaging, fund an emergency account, estimate and prepare for out-of-pocket expenses "along the way" to retirement, augment savings for income replacement purposes, and, of course, provide tax-free reimbursement of qualifying expenses—today and tomorrow.

Modest changes to current code and regulations will enable more workers to prepare (See Sidebar #3, Funding Solutions—Minor, Low Cost Changes That Would Add Significant Value).

Get started. ■

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