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All Things Financial Planning

Jason Foster, Director of Financial Planning, JD
Brad Bickham, Managing Partner & Chief Investment Officer, CFA, CFP®

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SUMMARY:

- Introduction
- Pre-Medicare Health Insurance Planning

Dear Clients,

Inflation continues to run hot. The latest Consumer Price Index (CPI) reading on June 10th showed a year-over-year increase of 8.6% for May, up from the 8.3% reading in April. The biggest contributors to the latest jump in inflation were shelter, gasoline, and food, according to Bureau of Labor Statistics. A broader measure of inflation favored by the Federal Reserve is the Personal Consumption Expenditures (PCE) index. It showed a 6.3% increase for the 12 months ending in April, and the so-called core rate was 4.9%. This core rate is what the Fed focuses on and their long-term target is for it to average 2%. In reaction to the latest inflation readings, the **Fed raised interest rates by .75% on June 15th** and left open the possibility of an additional .75% increase in July. Inflation may (or may not) have peaked in May, but it is certainly not coming down as fast as the Fed would like. They have signaled clearly to the market they will increase rates aggressively to cool demand and get inflation down to 2% eventually.

As for Congress and the Biden Administration, although I'm sure they would be all too happy to pass legislation or institute policies that would have a considerable effect in curbing the rising costs of goods and services, realistically speaking, not much can be done to fight inflation from a policy perspective. The White House made an announcement at the end of March that it would release 180 million barrels of oil from the Strategic Petroleum Reserve (SPR) over a 6-month period. Given that refineries in the US are running at near full capacity, the impact of this move might be limited, as the price of gas has continued to creep up since the move. This summer could see new record highs for gas prices in the US.

Biden has also taken steps to combat growing food prices by increasing domestic farm production and clamping down on oligopolistic industries they allege are abusing their pricing power, particularly the meat industry. But this is likely a long-term play and increased food production that could drive down prices overall are unlikely to materialize anytime soon.

On June 6th, the White House announced a 2-year pause on the possibility of tariffs on solar panels manufactured in southeast Asia. The hope is that this announcement will revive the momentum for US clean energy projects that existed when Biden took office. In a related move, the administration also announced that it will invoke the Defense Production Act to support the manufacturing of US made solar panels, helping to clear the way for more domestic production. But PIMCO believes that even if the Biden administration removed all the tariffs put in place by the Trump administration, which according to some estimates cover nearly 2/3 of goods imported from China, it may only have a .3 percentage point impact on CPI.

Drug pricing controls and renewable energy tax credits were part of the president's Build Back Better (BBB) agenda, but this legislation has gone nowhere in Congress. A skinnier version of BBB is still possible, but with mid-terms looming this fall, the stalled legislation would need to be kick-started soon to have any chance of passing. Remember that the reconciliation strategy that allows for certain provisions of a bill to pass with only 50 votes (and not 60) is still out there until the end of September. This would be the effective deadline.

Whether looking at the PCE or the CPI, inflation is running hotter than anticipated or wanted. It has more to do with supply constraints than demand, and as stated previously, government policies will make little difference. Eventually, rising interest rates should accomplish the Fed's goal to slow demand just enough to reduce inflation pressures and allow supply bottlenecks to ease. Still, it is a difficult balancing act to achieve without tipping the economy into recession.

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You may wonder if we have adjusted our financial planning models to assume higher inflation in the future. The answer is yes, but we do believe the Fed will be successful in bringing inflation down and that supply issues will be resolved. This may take one to three years, but the current levels of inflation will not continue indefinitely in our view. Therefore, we are increasing our long-term inflation assumption from 2.5% to 2.75%. As the Fed Chairman likes to say, we'll be data dependent and flexible as the facts change, and we'll continue to have candid discussions about how the increase in the cost for various goods and services might affect the longer-term success of our financial plans. Let us know if you have questions, would like us to run some numbers to analyze any upcoming decisions you may have related to your finances, or if you'd like to revisit any plans we have done for you in the past. We are here to help.

On a related note, one very important decision we assist clients in making is when they feel they can comfortably retire. We analyze countless factors and variables in assisting clients with making this decision. This newsletter has a detailed article exploring one of these variables: assuming you have the ability to retire prior to age 65, how to manage health care insurance and costs before you are able to take Medicare. The article focuses on factors to consider and health care options available as you plan for this next phase of your life.

Pre-Medicare Health Insurance Planning
By Nicki Green, Associate Financial Planner, CFP

For clients who want to retire prior to the Medicare eligible age of 65, significant thought and planning should take place regarding the healthcare options that are available as you consider transitioning away from the health insurance provided by your employer. **Health care costs are typically one of the biggest expenses for retirees**, with total projected lifetime healthcare costs for a healthy 65-year-old couple retiring in 2022 expected to be over $315,000 (after tax), according to a new estimate by Fidelity. This number can be exacerbated by people living longer (as if that's a bad thing) and healthcare inflationary numbers that continue to outpace the rate of general inflation. From a planning perspective, outside of your actual health, some additional factors affecting the overall cost of healthcare are the type of accounts you use to pay for healthcare – e.g., 401k, HSA, IRA, or taxable accounts, your tax rates in retirement and potentially even your gross income.

It is important to note that the above statistic is applicable to a couple *after* they take Medicare. If the same couple is planning on retiring prior to 65, the overall cost of healthcare will rise considerably due to the cost of funding the actual base health insurance. The decision to retire prior to 65 and taking on added healthcare costs might affect other decisions as well. According to Fidelity, approximately 1/3 of "early retirees" will claim Social Security at 62 to help pay for health care expenses until they are eligible for Medicare at 65. Postponing retirement or having enough saved to cover health care costs until 65, might allow you the optionality to defer the Social Security benefits until later, which will translate into a larger overall social security payout, assuming you live a long life.

Assuming significant pre-retirement planning has been done, taking into account all of the moving parts that make the decision a sensible one, you still must explore and secure health insurance. The rest of this article lays out possibilities for **health insurance coverage prior to Medicare**, and will provide some guidance on the options that are available. Once these options are fully explored, we can adjust and update the planning numbers accordingly to reflect these costs and illustrate the overall effect on the financial plan.

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The first place to explore for health insurance is your current employer to see if there is some type of **retiree health care coverage** available so your employer provided health insurance can be extended. This likely is the most affordable option. Unfortunately, more and more employers are dropping their retiree medical plans, so this option might not be available. Assuming there is no available health insurance post-retirement through your employer, there are 4 health care insurance options (and a 5th, non-insurance option, for those willing to take significant risk) to bridge the gap years prior to Medicare kicking in at age 65.

COBRA

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) allows a person to continue the health care coverage previously provided by their employer for a pre-determined amount of time. Although this provides some continuity and a potential bridge to Medicare depending on the length of time needed and policy details, this option usually results in one paying the full cost of coverage plus a potential 2% surcharge. It is generally considered the most expensive option, and COBRA coverage may only be available for 18 months. Also, if your company is less than 20 employees, there is no requirement the company needs to comply with COBRA.

Although it's possible the government could subsidize the benefit as well, not everyone automatically qualifies for COBRA. Individuals typically need a qualifying event to access the benefit, such as an involuntary termination of employment or reduction in hours. But if you are voluntarily retiring, these qualifying events would not apply. Consult your current plan and talk to human resources to understand how your current health care insurance and COBRA coverage works, the circumstances where COBRA could be accessed, and potential cost of utilizing the benefit. If COBRA is a possibility, even for a limited amount of time, it can be used as a comparable against other possible plans.

Spouse/Partner's Employer-Sponsored Plan

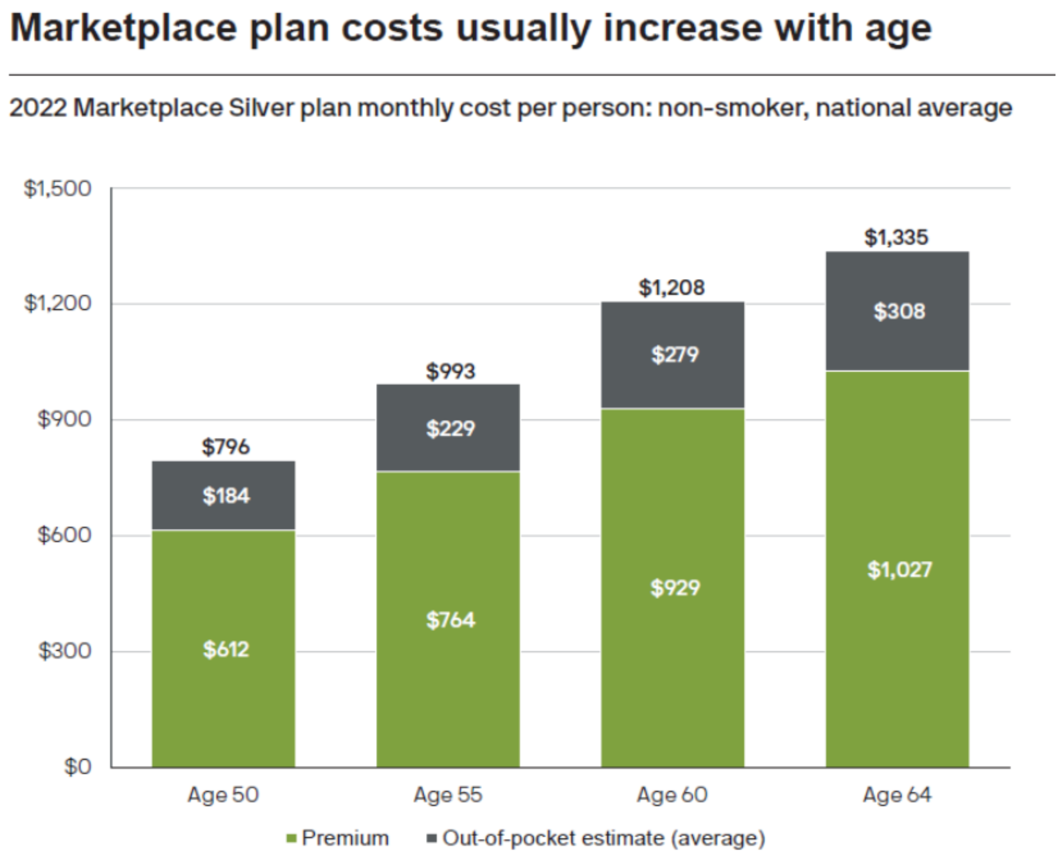
For a potentially more economical option, or if your plan is to retire several years prior to age 65, your spouse or partner might be a healthcare insurance resource for you. But this also assumes a strategy that you and your spouse or partner are retiring at different times, or is at least dependent on your significant other continuing to work at least part-time. If there is a need in the financial plan for the extra money that will be earned by your spouse or partner, then utilizing their employer's health insurance to cover both of you is certainly worth exploring. If you can be added to their plan, this might be the best and least expensive health care coverage option available until you both qualify for Medicare.

Public Marketplace

The Affordable Care Act (ACA) established a public marketplace health insurance option for those not yet eligible for Medicare. Costs vary widely, but subsidies can be available through premium tax credits to help offset the expense.

In Colorado, you can access this marketplace through a site called Connect for Health. Although open enrollment is from November 1st through January 15th, if you miss this open enrollment period, a "Qualifying Life Change Event," such as retirement, will allow you to still enroll outside of these dates. Such a life change event allows you 60 days to apply for health insurance through the exchange, from the date of retirement. Health insurance companies that provide health insurance for Coloradans through the Connect for Health marketplace include Anthem, Cigna, Kaiser Permanente, and United Healthcare, among others. There are Gold, Silver and Bronze plans, depending on the balancing of premium costs and coverage needed. All of these plans cover 10 essential benefits, such as coverage for hospitalizations, outpatient and preventive care, maternity and child services, lab tests, rehabilitation services, mental health treatment and prescription drugs.

Premium costs will vary considerably based on the state, plan selected and other factors. For example, as shown on the below chart, the national average premium costs associated with an individual utilizing a Silver plan in the marketplace will be between $900 and $950 per month at age 60, with the cost rising above $1000 per month once the same individual reaches the age of 64, per J.P. Morgan's Guide to Retirement Report for 2022. This equates to an estimated expense of $60,000 or more in the 5 years prior to being Medicare eligible. This is for premium costs alone and does not include out -of-pocket estimated expenditures. You can see what is a fairly significant increase in the combination of premiums and out-of-pocket expenses is as you go from your 50s into your 60s, on the chart provided.



The marketplace also offers dental plans through Anthem, Cigna and Delta Dental, as well as vision coverage through Vision Service Plan (VSP). There is a cost and plan finder available to get you started, although the site requires you to enter personal information in order to access this resource for general quotes.

You can visit Connect for Health at the following site for more details: https://planfinder.connectforhealthco.com/home. There are also several brokers and agents that specialize in assisting individuals find health insurance through this marketplace.

<u>Private Insurance</u>
For comparison, you can also use a local health insurance agent/broker **to find healthcare coverage from multiple providers outside of**

Connect for Health. Since these "off-exchange" plans do not have a requirement to comply with the Affordable Care Act, coverage can be flexible, more comprehensive and customized towards a person's needs. However, because the ACA does not regulate private insurers, there is generally no coverage for pre-existing conditions and the government-funded premium tax credits discussed in the previous section cannot be applied to these types of plans, which could mean premiums are more expensive.

If you would like to explore this avenue, we have some health insurance broker contacts that may be useful as you compare and contrast different options. You can also contact health insurance companies or pursue online health insurance sellers if you would prefer to contact them directly.

	Target audience	Estimated cost	Considerations
COBRA	Former employees	\$\$–\$\$\$	Few employers subsidize COBRA; you may need to pay the full cost of the coverage.
SPOUSE'S PLAN	Eligible spouses/partners of covered employees	\$–\$\$	Not all employers offer this benefit; special rules or surcharges may apply.
PUBLIC MARKETPLACE	Anyone	\$\$–\$\$\$	Qualification for federal assistance is based on your income level.
PRIVATE INSURANCE	Anyone	\$\$–\$\$\$	Your former employer may provide a reimbursement account that can be used to help offset the cost of these plans.

<u>Self-Pay</u>

As of January 1, 2021, a federal regulation now requires hospitals to publicly post their "standard charges" from a self-pay perspective. This means a patient could potentially pay less utilizing cash rather than having health insurance and billing insurance directly, especially if they have a high-deductible plan where they have not yet met their annual deductible. Also, for many procedures such as an X-ray or MRI (common outpatient procedures), the cost of using cash may be significantly cheaper than billing via insurance.

The caveat, of course, is that one of the purposes of having any form of insurance in place, including health insurance, is to cover any potential catastrophic events. There is no longer a penalty imposed for not having ACA mandated coverage, but there is significant financial risk in not having insurance in place and simply paying all healthcare expenses out of pocket. Although we don't recommend this approach as financial planners, if you can stomach the risk and have significant non-taxable liquidity and cash saved during your pre-retirement years, you might be able to bridge the gap to Medicare using these reserves for health care needs, although the longer the gap the greater the risk.

One preferred resource that could be available to you in the pre-retirement planning phase to assist in paying for these health care expenses during retirement are **Health Savings Accounts (HSAs)**. These accounts provide an incredibly tax efficient way to save for healthcare costs in retirement. We have written about the benefits of utilizing an HSA in a previous newsletter article, but in summary, they provide a tax deduction upfront when you contribute, they grow tax free within the account, and when a qualifying withdrawal is made to pay for health-related expenses, these distributions are tax free as well. If an HSA is available, maximizing contributions to this account well in advance of your estimated retirement date would be an important planning step to building reserves to assist with the cost of healthcare during retirement, regardless of what you decide upon for health insurance prior to Medicare.

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Irrespective of which of the foregoing options is the best one for your specific circumstances, careful financial planning should take place if one desires to retire earlier than the Medicare qualifying age of 65. Health insurance options are available, but many of these insurance plans can be more expensive than presumed. The cost of these plans can vary considerably, depending on a number of factors, including family size, location, age, tobacco use, plan category, and overall health. And the expected trajectory of costs associated with these healthcare insurance plans are not expected to change anytime soon. Health care costs will likely continue to outpace the basic inflationary assumption in our plans by a significant amount. We currently use a 6% annual inflation assumption for the cost of private medical insurance prior to Medicare, and this long-term average yearly assumption may be subject to go upward.

Our financial plans will project and model out how these expenses can affect both cash flow and your balance sheet as you are approaching retirement, and after you fully retire. We anticipate this detailed modeling will assist you in making a decision on a realistic retirement age, and will continue to be a valuable resource for you well into your retirement years. Feel free to reach out to your advisor or the planning team here at CFM to see how we can help.

The Financial Planning Department
And Your Entire Colorado Financial Mgmt. Team