Setting savings goals and steadily building your nest egg are important steps toward a secure retirement. But even the best-laid plans need occasional adjustments in response to shifting trends.

Stock market fluctuations are a prime example, but not the only one. A concern that may be just as significant for workers of all ages is retiree health care.

In fact, the sharply rising cost of health care in America has become one of the primary risks to a financially secure retirement, a growing number of economists and financial planners say.

Health insurance premiums and medical expenses consume a hefty portion of retiree savings at today's levels. But the future looks more troubling. Health care costs are expected to continue to increase faster than inflation, and many employers are re-evaluating their ability to continue to offer the same level of retiree health insurance coverage.

Despite recent passage of a Medicare prescription drug benefit, Fidelity's Health and Welfare consulting experts estimate that a couple retiring today at age 65 will need $190,000 in savings to pay the health care tab. The total is even higher if you include potential long-term care costs for living in a nursing home, or if you're thinking about retiring early.

"If workers do not plan early for potential medical costs during retirement, they may not be able to afford needed medical care or they may become destitute trying to pay for it," warned University of Notre Dame professor H. Fred Mittelstaedt in recent testimony before Congress.

Experts like Mittelstaedt point to several trends that are driving the need for individuals of all ages to evaluate how rising health care costs will affect their retirement savings needs and to regard adequate health insurance coverage as an essential part of their retirement plans.

Soaring medical costs
One of the most-talked-about trends is the skyrocketing costs of medical care, which has outpaced inflation for the past 20 years. Health care spending grew 7.5% in 2004, and is expected to reach $6,423 per person in 2005, according to the journal Health Affairs. Increases are expected to continue in the years ahead, with many companies predicting that costs will grow by 10 percent or more annually.

Personal out-of-pocket costs can be especially steep if you retire early and must purchase coverage on your own until you become eligible for Medicare. Of course, expenses will vary greatly depending on how long you live, your health status, and the cost of medical care in your area.
The Baby Boomer effect
Looking ahead, an aging population is likely to put additional pressure on the health care industry. The 2000 U.S. Census found that one in eight Americans was 65 or older, but demographers estimate that by 2030 the ratio will shrink to one in five, giving America its largest proportion of retirees in history.

The Baby Boomer retirement "bubble" is forcing employers to rethink how to structure their retiree health insurance plans. Over 80% of companies with more than 200 employees surveyed by the Kaiser Family Foundation in 2004 said they were likely to increase the amount their employees pay for health insurance. That's making it more important than ever for employees to familiarize themselves with what their employers offer and to evaluate how health care costs will impact their retirement.

What about Medicare?
As Baby Boomers approach retirement and medical costs continue to rise, who's going to meet the growing need? Government-sponsored Medicare is part of the answer, but it has significant limitations.

Most people qualify automatically at age 65 for Medicare hospital insurance (known as Part A), which doesn't cost you a penny if you or your spouse paid Medicare taxes during your working years.

There's a monthly premium, however, for Medicare medical insurance (Part B), which covers doctors' services, outpatient hospital care, and some other medical services such as physical and occupational therapy and some home health care.

Beyond the monthly premium for Part B ($78.20 in 2005), it's important to keep in mind that there's no annual limit on out-of-pocket expenses, as there is with many private insurance policies, and there are significant medical needs that aren't covered by Part A or Part B.

"Employees have become accustomed to company-sponsored insurance coverage that pays typically 80 percent or more of their medical costs while they are employed, and they expect the same thing from Medicare," says Sunit Patel, vice president-Health and Welfare at Fidelity. "But there are many studies that show Medicare picks up only about 50 to 55 percent of a person's total medical costs in recent years."

The new Medicare drug benefit and other coverage changes enacted early in 2004 will increase those percentages by about 5 to 10 percent, which is perhaps not as much as some retirees would have hoped. For the average retiree, who the Kaiser Foundation projects will spend $3,160 on prescription drugs in 2006, the year that Medicare Part D becomes effective, the new drug benefit will reduce out-of-pocket costs by only $1,080.

Those savings will be quickly eaten up by continually rising health care costs overall, Patel points out. Plus, some key items, such as vision, at home care, and dental care, will continue to fall outside of Medicare coverage.

Filling the gap
Some retirees are able to fill the Medicare coverage gap with
insurance from their former employer. About one-third of Medicare's 40 million beneficiaries have employer-sponsored supplemental coverage, the U.S. General Accounting Office reported in 2002.

For the poorest retirees, there is help in the form of Medicaid, a federal/state welfare program for the near destitute. Retirees not covered by an employer's policy or Medicaid can purchase a Medigap policy to help pay costs not covered by standard Medicare. Standardized Medigap policies come in 10 levels with costs that increase accordingly with the level of coverage.

Alternatively, rather than enroll in traditional Medicare, retirees may choose a plan through the Medicare Advantage program, formerly known as Medicare “plus” Choice.

What you can do
Anyway you look at it, paying for health care in retirement is expensive and, despite recent changes to Medicare, is likely to become much more so. Rather than rely on guesswork and government action, you can take control of your future retirement health care costs by following these steps:

• **Check your company's retirement benefits.** You might work for a company that provides retiree medical benefits, but make sure you understand how much of the premium you will be required to pay, along with deductibles and co-pay amounts. Also, keep in mind that your employer's benefits could change by the time you're ready to retire.

• **Make sure you have adequate insurance.** Having sufficient health insurance for your needs is critical for protecting your retirement savings. If you're planning to retire before age 65, you won't be eligible for Medicare, but you might be able to buy insurance under your company's group plan for active workers. If not, shop around for an individual policy that meets your needs. If you are 65, Medigap insurance should be a retirement plan priority. Also, Medicare Advantage regional PPO plans will become available in 2006, offering retirees in all areas greater potential for finding a privately managed plan that may offer lower premiums or better benefits than traditional Medicare.

• **Understand the risks of long-term care.** Roughly 50% of Americans now turning 65 will be admitted to a nursing home at some point in their lives. Because the average annual cost of full-service nursing home care ranges between $33,000 to $91,000, depending where you live, financial planners increasingly recommend looking into long-term care insurance in addition to a solid health care policy.

• **Estimate your anticipated medical costs.** In addition to getting a handle on what health insurance is going to cost, you should evaluate your general health and your family’s health history. If your risk of heart disease is high, for example, you should pay close attention to hospital deductibles and drug costs, as well as keeping in mind that there's no limit, under Medicare, on your out-of-pocket expenses.

• **Review your retirement plan.** Many retirement planning models don't adequately take into consideration the cost of health care. Once you know what to expect in the way of health care costs in retirement, you can determine how much additional savings you are likely to need.
Choose a method for saving. Many experts recommend starting a separate fund or account specifically to pay for health care costs in retirement — much like a separate account for a child's college education. The advantages of that approach are that it adds focus to your saving and it allows you to better assess your progress toward your goal. Even if your anticipated retirement health care costs seem high, you can reach your goal by starting now and contributing regularly as part of a disciplined plan.

Helping you plan
No matter your age, the time to start thinking about health care in retirement is now. Financial planners and economists agree almost universally that health care is going to be a major expense for retirees for the foreseeable future, much more so than many workers might have anticipated.

To educate employees about the cost of health care in retirement and to help them develop accurate estimates, Fidelity is providing planning resources, including a Retirement Health Care Calculator, and actively encouraging employees to be aware of the issue.

Planning and saving adequately for medical expenses will prevent painful consequences later, Patel says. Employees who save now are more likely to be able to enjoy the activities they have always looked forward to, such as travel and recreation.

"It's very important for people to remember that most health care costs aren't optional like the lifestyle choices you make for your retirement," Patel says. "So when you have to make trade-off decisions, it's the optional activities that have to be dropped."

The good news, he adds, is that Baby Boomers in the 38 to 55 age range have sufficient time to adjust their savings strategies to meet their retirement health care needs.

"If you set up a separate account and contribute the same way you do for other future needs," Patel says, "you'll greatly improve the chances that your retirement will live up to your expectations."

Rick Sauder is a freelance writer based in Lancaster, Pa. and a frequent contributor to Stages® magazine.

The estimates of $160,000 and $200,000 are expected-value calculations and will vary from individual to individual. For example, the amounts could be insufficient for those who live well beyond their life expectancy and/or whose health status is significantly worse than average.