Morgan Stanley

Your Financial Future

Tips and insights to help you reach your goals

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Healthcare Costs and Retirement: A Rising Concern

You know it’s important to save enough during your working years to cover your costs in retirement. But you may not realize just how steep those costs might be, particularly when it comes to healthcare, which will likely be your biggest expense during your retirement years.

How big? Estimates vary, but taking into consideration that healthcare costs are rising faster than inflation and that healthcare spending increases with age, the figures could be daunting.

- According to a study from the Center for Retirement Research at Boston College, the average retiree spends around $4,300 per year[1] on out-of-pocket healthcare costs, and that doesn’t include long-term care.
- A healthy 65-year-old couple retiring this year will spend $369,000 in today’s dollars on healthcare over their lifetime, according to Milliman. In future dollars, that increases to $551,000. By age 85, their healthcare expenses are 250% higher than at age 65.[2]

Medicare will help cover some costs, but coverage is far from free, and you'll still face some out-of-pocket expenses. But while rising costs might seem out of control, you don’t have to be if you’re aware and prepare. Here’s how.

Estimate your expenses.

You can’t plan for what you don’t know, so it’s a good idea to get at least a ballpark figure on your future healthcare costs. One way to do so is with the AARP Health Care Costs Calculator, a free tool that can help you estimate how much you will pay for healthcare, based on the condition of your health. In addition to estimates, the calculator offers a personalized plan to help you minimize costs.

Keep contributing to your 401(k) plan.

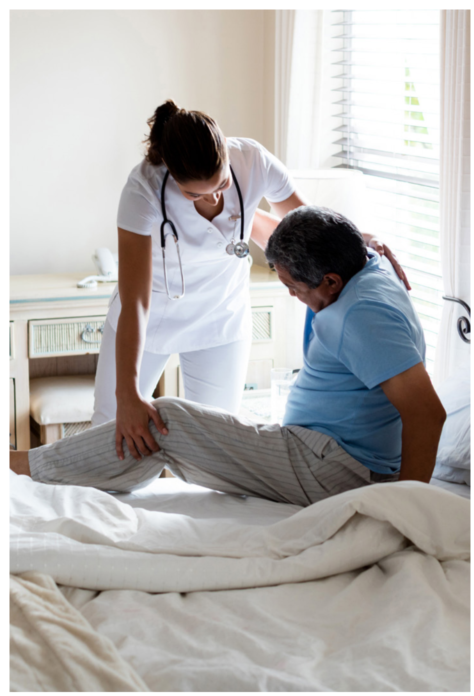
According to the Employee Benefit Research Institute (EBRI), many workers are making the mistake of letting rising healthcare costs get in the way of smart retirement planning strategies[3]:

- 50% of workers have reported increased healthcare costs in the past year
- 28% have decreased their retirement plan contributions
- 12% have taken a loan or withdrawal from their retirement plan

Instead of depleting your retirement savings account, you may be doing yourself a huge favor by maintaining—or better yet—increasing your contributions. You should also consider allocating more to equities while young and healthy, then slowly increasing the allocation to fixed income as you get closer to retirement. During retirement, the increased allocation to fixed income can seek to cover large, unpredictable healthcare expenditures. Meanwhile, a sustained, but smaller, equity allocation, which offers greater growth potential, could help you pursue sufficient asset growth to cover healthcare costs over a long life span.

Get professional advice.

Your financial advisor can help you adopt an investment strategy that addresses the reality of rising healthcare costs while taking your own individual needs and circumstances into account.



[1] 'An expensive problem’: How much will health insurance cost in retirement?,” USA Today, https://www.usatoday.com/story/money/2019/07/08/how-much-will-health-insurance-cost-in-retirement/39661287/, accessed October 2019.

[2] Even Healthy Couples Will Face Extreme Health Care Costs in Retirement,” PLANSPONSOR, July 2, 2019, https://www.plansponsor.com/even-healthy-couples-will-face-extreme-health-care-costs-retirement/, accessed October 2019.

[3] Workers Like Their Benefits, Are Confident of Future Availability, But Dissatisfied With the Health Care System and Pessimistic About Future Access and Affordability,” EBRI Notes, October 19, 2016.

New Rules for Hardship Distributions

Withdrawing money from your retirement account should be a last resort after all other funding sources have been exhausted—but emergencies happen, and it's important to understand the rules. On September 23, 2019, the IRS published regulations that will affect how retirement plan participants can make hardship withdrawals.

These final regulations:

- Allow most participants to take distributions from additional contribution sources (including earnings)
- Allow distributions without first requiring the participant to take a plan loan
- Allow employees to continue making plan contributions immediately after receiving a hardship contribution
- Add another reason for being able to take a hardship distribution
- Make it easier to start saving again following such a withdrawal

Hardship Distribution Overview

You must meet two conditions before obtaining a hardship distribution:

1. You must have an "immediate and heavy financial need."
2. The distribution must be necessary to satisfy that financial need.

The previous hardship regulations (adopted in 2004) identified six reasons that were deemed "immediate and heavy" financial needs:

1. Unreimbursed medical expenses
2. Costs for purchasing a principal residence
3. Certain educational expenses
4. Payments to avoid eviction from or foreclosure on a principal residence
5. Certain funeral expenses
6. Costs to repair damage to a principal residence

The final regulations add a seventh reason:

7. Federal disaster declarations, which include "expenses and losses—including loss of income—incurred by the employee" (but not the employee's relatives or dependents) in FEMA-declared disasters.

Learn more.

The new hardship distribution rules apply to distributions taken on or after January 1, 2020, but employers may choose to apply the rules to distributions taken in plan years beginning after December 31, 2018. To learn more about the new hardship distribution regulations and plan amendment deadlines, contact your financial advisor.

Retirement Plan Resolutions: No Willpower Needed

Lose weight. Exercise. Get organized. Sleep more. If you're like most people, you make and break the same New Year's resolutions year after year. In fact, according to an article published in U.S. News & World Report, 8 in 10 people typically fail to keep their resolutions by the second week of February.[1]

Instead, how about shaking things up this year and making some New Year's resolutions for your retirement savings plan that are easy to keep for the long term—no willpower needed!

Start Small, Grow Big.

Even small amounts contributed regularly to your 401(k) plan can make a huge difference when you retire. While it may never be too late to begin saving, the earlier you begin, the more time your retirement savings will have to potentially grow. Not only that, but starting early gives you an opportunity to take advantage of the tax-deferred growth that your plan offers, since you won't have to pay taxes until your assets are withdrawn (typically at retirement when you may be in a lower tax bracket).

Max It Out.

Contributing 4% or 5% of your salary to your retirement savings plan is a great place to begin, but most experts recommend increasing contributions to 10% to 15% (including any employer contributions).[2] So try to increase your contributions as much as you can this year—and going forward—to get yourself closer to that ultimate target.

Make It Automatic.

401(k) plans offer virtually effortless options for contributing. By scheduling recurring contributions to be drawn automatically from your paycheck, you can make saving for retirement a habit, ensuring you'll never miss a chance to contribute.

It's 2020, and you're one year closer to retirement. Don't waste time—get your retirement savings plan in better shape now, with resolutions that are easy to keep.

[1] https://health.usnews.com/health-news/blogs/eat-run/articles/2015-12-29/why-80-percent-of-new-years-resolutions-fail, accessed October 2019.
[2] https://money.cnn.com/retirement/guide/basics_basics.moneymag/index7.htm, accessed October 2019.