KANAWHA CAPITAL MANAGEMENT, LLC

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KANAWHA CURRENTS

Navigating the Medicare Maze

This Quarter's Highlights

- Medicare Basics
- Medigap vs. Medicare Advantage
- Case Study

Anyone approaching the Medicare eligibility age of 65 has plenty of health insurance options to choose from, beyond basic Medicare. People can find it hard to select among the many different Medicare Advantage plans and Medicare Supplement Insurance ("Medigap") plans available. Given that healthcare costs are rising significantly faster than retirement income, making an uninformed decision can have serious financial consequences. Also, retirees typically use more medical services during their later years of retirement, so planning is important. Together, cost inflation and greater usage with age are contributing to a growing future liability for our nation's seniors. To combat this and minimize financial exposure, retirees and pre-retirees must educate themselves on the various forms of health insurance.

Medicare, the principal insurance for retirees, by itself provides limited coverage and can leave one's financial savings vulnerable. This is where Medicare Advantage and Medigap plans come into play. There is certainly no shortage of choices. A resident of Richmond, Virginia, for example, currently can choose from more than 20 Advantage plans. There are also 11 federally mandated Medigap options, with multiple carriers providing coverage for each of these plan types. We will review some of the Medicare basics, explore the expanded coverage options, and discuss what should be factored into making an informed decision.

Let's first review the costs and benefits of traditional Medicare. *Part A* (Hospital Insurance) generally requires no monthly premium if you are age 65 or older and you or your spouse have paid Medicare taxes for at least 10 years. An annual deductible of $1,156 per benefit period and co-payments for stays beyond 60 days will apply. Part A helps to cover inpatient care in hospitals and skilled nursing facilities as well as hospice care services. It does not cover custodial or long-term care. *Part B* (Medical Insurance) requires monthly premiums, which are calculated based on your modified adjusted gross income (MAGI; see Table 1), an annual deductible of $140, and 20% coinsurance for most services. Part B covers doctor's visits and services, outpatient care and lab tests, among other benefits.

Table 1: 2012 Medicare B Premiums

MAGI Single	MAGI Joint	Part B Monthly Premium
$85,000 or less	$170,000 or less	$99.90
$85,001 to $107,000	$170,001 to $214,000	$139.90
$107,001 to $160,000	$214,001 to $320,000	$199.80
$160,001 to $214,000	$320,001 to $428,000	$259.70
$214,001 +	$428,001 +	$319.70

If you haven't started receiving Social Security retirement benefits, you will need to sign up for Medicare A and B. You may do this during a seven-month period that begins three months before the month you turn 65. You may wish to enroll in Part A and defer Part B to a later date if you have access to group medical insurance through current employment. Upon retirement or termination in coverage, you will have an eight-month window to enroll in Part B (the same would apply to Part A if you didn't originally enroll in this). Missing your initial or deferred enrollment can leave you exposed to penalties and lack of coverage until the next year's open enrollment and subsequent July 1 effective date.

Prescription drug coverage, or *Part D*, became part of Medicare in 2006 with the passage of the Medicare Modernization Act. It can be purchased as a stand-alone prescription drug plan or as part of a Medicare Advantage plan. Stand-alone plans come with various monthly premiums, annual deductibles, and coinsurance depending on the policy. Many plans have a gap in coverage from $2,930 to $4,700 in which participants may be responsible for up to 100% of the cost. This is often referred to as the "donut hole" and is scheduled to be gradually phased out by the Patient Protection and Affordable Care Act. Some plans provide "gap coverage," but these plans often come with higher premium costs. It is important that you consider Part D coverage during your initial enrollment period, even if you do not have prescription needs at the time. There is a cumulative penalty that increases each month you defer between the time you are first eligible and the time you ultimately sign up for Part D. Consequently, it may make financial sense to go ahead and sign up for one of the less expensive plans, as you can always change your prescription drug coverage during a later open enrollment period.

After becoming familiar with the different parts of Medicare, individuals can begin to analyze whether (a) Medicare only, (b) Medicare Advantage, or (c) Medicare *and* Medigap is most appropriate for their needs. For those retirees with employer sponsored health plans, it is important that you discuss with your benefits personnel how your plan works with Medicare. Many employer plans offer sound coverage, but one must be diligent in learning how these plans interact with Medicare and what their net exposure might be.

Cost is perhaps the most critical factor among many retirees facing the question of healthcare coverage. After all, rising healthcare costs is *the* issue at play here. However, using a cost-only approach would essentially reduce your options to the most basic form of coverage, Medicare only. A more effective process begins with identifying the retiree's desired benefits and then finds the lowest cost solution to meet one's criteria.

Several factors should be considered in determining which course to take. These questions touch on some of the most important issues that should be addressed in analyzing different health insurance options. How you answer these questions will often help you determine the right plan for you.

- How important is it for you to keep your current physician(s)? Are you comfortable switching to other doctors?
- What level of flexibility do you want in terms of selecting a new physician if the need arises? How might a PPO or HMO network affect your choice of physicians?
- Are you able to maintain proper coverage if you spend part of the year in one location and part of the year in another?
- What level of catastrophic coverage are you comfortable with? Based on your level of financial assets, you may be fine with being exposed up to a certain threshold, but not beyond it.
- Are there other benefits that are important to you that are not covered under Medicare, such as routine vision or dental care?
- What prescription drugs do you take and how do you prefer paying for them?

Many people have spent years diligently saving for retirement, and they often maintain an overarching objective of preserving and growing their savings. For most retirees, their investment portfolios serve to fund a majority of their ordinary living expenses in retirement. In this context, the concept of financial exposure involves the risk of having to tap into this capital to pay for healthcare costs not covered under one's health insurance. Unexpected and significant expenses may threaten to undermine a retirement portfolio's sustainability, especially if forced withdrawals coincide with market downswings. Therefore, it seems logical that retirees should consider paying for extra coverage beyond basic Medicare. The two broad options that can generally provide additional coverage are Medicare Advantage and Medigap plans.

Evaluating Medicare Advantage plans is no easy task. They come in many different shapes and sizes and are offered by private companies that have been approved by Medicare. Technically, they are not supplemental policies, as they provide an all-in-one option that bundles Part A and B benefits and may include additional dental, vision, and wellness coverage. Most Advantage Plans also have prescription drug (Part D) coverage.

Medigap plans, on the other hand, are separate policies that provide coverage to supplement the benefits received under Parts A and B. They also are offered by private insurers and are designed to cover Medicare deductibles, co-payments and coinsurance. They come in 11 standardized designs. Each of these designs must provide the same benefits, no matter which insurance company is writing the policy. Table 2 attempts to conceptually compare and contrast Advantage plans to Medigap plans.

Table 2: Medigap vs. Medicare Advantage

	Medigap	Medicare Advantage
Eligibility	Entitled to Part A and B if paid Medicare taxes for 10 years.	Entitled to Part A and B if paid Medicare taxes for 10 years.
	Must pay Part B premiums.	Must pay Part B premiums.
	No medical underwriting during Open Enrollment Period and Guaranteed Issue Period. Otherwise, underwriting will typically apply.	Available to all applicants except those with End Stage Renal Disease.
	No residence restrictions.	Must reside in service area.
Flexibility/Provider Choice	Any provider who accepts Medicare.	Generally HMO and PPO networks. HMO's cover in-network only. PPO's may cover out-of-network, but costs may be higher.
	No referrals required.	No referrals required for PPO's in-network service. Referrals may be required for HMO's.
Catastrophic Coverage	Excellent.	Varies by plan, but limited to $6,700. This may not include out-of-pocket prescription drug coverage.
Prescription Drug Coverage	None. Have to purchase a stand-alone prescription drug policy.	Most plans come with prescription drug coverage.
General Benefits	Benefits vary based on each of the 11 standardized plans, but generally pay for all or a portion of costs not covered under Medicare A and B.	Benefits vary widely with plans but generally offer low deductibles and copays for medical services.
Extra Coverage	No routine vision, dental, or wellness.	Some plans may include vision, dental, or wellness.
Cost	Premiums vary with gender and age. Insurance companies structure premiums in three different ways (community, issue age, and attained age).	All plan members pay same premium. Many plans have no premiums as network savings and Medicare subsidies reduce cost.
	Premiums generally higher as they cover more out-of-pocket expenses.	Premiums typically lower but cost sharing may be higher with care. Total cost may be difficult to estimate, especially if needs/ frequency of care increases.

The above comparison matrix only addresses some of the many issues that should be factored into the healthcare insurance decision for Medicare enrollees. The information provided is of a general nature and specific plans and personal circumstances may yield different outcomes.

Understanding the different healthcare insurance options for Medicare enrollees and trying to determine which strategy best meets your needs can be a daunting task. The importance of this decision on retirees' assets is magnified by (a) the trends of high healthcare inflation and (b) the increased demand for medical services with age. Like many products and services available to the consumer, the decision often comes down to individual needs and preferences. A comprehensive Medigap policy paired with a solid prescription drug plan generally offers superior coverage for individuals willing to pay the increased cost. For those who are comfortable with network plans, desire a bundled approach, and are looking for more affordable premiums, Medicare Advantage plans may be a suitable fit. Regardless of your decision, it pays to review your plan(s) on an annual basis, especially stand-alone prescription drug plans and Advantage plans with prescription drug coverage. Importantly, while this discussion has focused on Medicare-covered expenses, individuals should be just as thorough in researching the various products that may help reduce financial exposure due to long-term care related costs.

Case Study

Bob and Sue Jones are married and soon to be retired. They are each approaching their 65th birthday and look forward to playing more golf and traveling in retirement. As part of their travel plans, they expect to go overseas at least once every few years. They reside in Central Virginia, are in relatively good health, and only take a few prescription drugs. They each take a generic cholesterol medication and Bob also takes a generic drug for high blood pressure. While they have grown accustomed to a high level of care in a PPO network offered through Bob's employer based coverage, he will not receive these benefits as part of his retirement package. They have saved diligently over the years and have a portfolio of assets of approximately $1.5 million. They expect Medicare Part B premiums, which will be deducted from their future Social Security checks, to be $139.90 per month per person.

After many hours of due diligence on the topic of supplemental health coverage, Bob and Sue have narrowed the choices down to a popular Medicare Advantage plan and one of the standardized Medigap "F" options, both offered by reputable insurance companies with high financial ratings.

Eligibility: *Since they are in their initial open enrollment period, there will be no underwriting issues for the Medigap policy. They understand, however, that if they choose the Advantage plan today but want to switch to a more comprehensive Medigap policy in the future, they may have to go through underwriting which would come with obvious risk.*

Flexibility: *The Advantage plan is offered through a PPO framework and they have already determined that their Primary Care Physicians operate within the network. However, they are concerned about not being able to choose future physicians for needs that might arise if those doctors are not part of this network. They also find it unsettling that they may have emergency needs while traveling and any care rendered could be offered out-of-network which would require higher out-of-pocket costs. They like the fact the Medigap option offers solid coverage for both domestic and foreign travel emergencies.*

Catastrophic Coverage: *While the Medigap option is clearly superior in terms of minimizing unexpected out-of-pocket expenses, they are fairly comfortable with the $4,500 limit of in and out-of-network costs that the Medicare Advantage plan offers.*

Prescription Drugs: *The Advantage plan has bundled prescription drug benefits which provides solid coverage for their drugs. This is appealing to them. The stand alone Part D plan which they would pare with the Medigap policy provides comparable coverage, but it comes with a higher premium cost.*

Extra Coverage: *The Advantage plan comes with the option to purchase dental, vision, and wellness benefits for a reasonable cost each month. Given that Bob and Sue regularly visit their dentists, they like the idea of being able to get bundled dental coverage through the Advantage plan. The Medigap option would require them to self-insure against this risk or get individual dental coverage.*

Cost: *The total cost for the Medigap "F" plan is approximately $300 per month or $3,600 per year per person. The total cost for the Advantage plan is more difficult to determine; however, based on monthly Part B premiums of $140 and an estimate from the Medicare Plan Finder of $95 for other copays and miscellaneous items, we can get a rough estimate of $235 per month or $2,820 per year per person. They certainly find the lower projected costs of the Advantage plan appealing, but they worry about these costs potentially increasing should they become ill.*

Each of the two options, the Medicare Advantage plan and the Medigap "F" policy, appears to provide adequate coverage to meet their needs. The Jones like certain qualities about both options. The Advantage Plan comes with bundled benefits and they have been quite comfortable in the past operating within a PPO framework. The Medigap policy, on the other hand, is an unbundled approach, but provides comprehensive coverage for the various deductibles, co-payments, and coinsurance that Part A and B do not pay for.