Healthcare costs in retirement

Preparing today to help protect your wealth tomorrow

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Preparing for healthcare costs to help you protect your retirement lifestyle

Like many people, you've worked hard over the years to build your wealth for a more secure future. But have you taken time to consider the effect that healthcare costs could have on your portfolio—and the fact that these costs could rapidly deplete your savings and adversely impact your retirement income?

At Merrill Lynch, we believe that whether you're approaching retirement or already well into your retirement years, protecting your wealth is just as important as building it. Properly preparing for healthcare costs, both those you expect and those that are less predictable such as a need for long-term care, will help improve the likelihood that your assets and your retirement lifestyle last a lifetime and beyond.

Providing solutions to help meet your healthcare challenges

We hope to provide you not only with a clearer understanding of the healthcare cost challenges that you will likely face over the coming years, but more importantly to offer solutions that may help you address those challenges by:

- Estimating your expected out-of-pocket healthcare expenses such as insurance copays and Medicare premiums;
- Creating contingency plans for unexpected expenses such as long-term care; and
- Working closely with your Merrill Lynch financial advisor to protect your wealth by integrating healthcare costs into your overall retirement plan.

Everyone's situation is different. Your Merrill Lynch financial advisor can help you better understand your unique challenges and how to address them in the context of your retirement goals and all the elements of life—family, finances, work, leisure, health, giving and home.

The healthcare challenges of retirement

Over the last two decades, the life expectancy of Americans has risen dramatically.[1] Like many things, however, longevity can be a double-edged sword. Because you can expect to live longer, you'll need to save more to avoid outliving your retirement savings or using assets you intended to leave to your heirs. And along with advancing age, also comes an increased likelihood of a costly health event.

While over time expected healthcare expenses can slowly drain retirement savings, a significant health event can quickly derail all your retirement plans. Without proper preparations, the only available source to pay those expenses will be your retirement assets.

The common belief that Medicare will cover the vast majority of healthcare expenses in retirement is simply not the case. A recent study by the Employee Benefits Research Institute estimates that the average "healthy" 65-year-old couple that retired in 2013 would need around $255,000 to have a 90% chance of covering medical expenses throughout retirement—with a risk of that amount being much higher.[2] These costs include copays and premiums for Medicare Part B and Part D, Medigap and retiree health insurance, as well as other services not covered by Medicare such as dental care, vision care and hearing aids.

Add to that the risk of needing long-term care in a nursing facility at a cost of hundreds of thousands of dollars, and the amount can quickly deplete your retirement assets.

Do you feel prepared for all the potential healthcare costs that could impact your retirement savings and income? Have you considered the effect these might have on the legacy you hope to leave for your children or grandchildren?

With proper planning, these risks can be greatly minimized or even eliminated. But in order to effectively prepare, you first need to be able to accurately estimate your expected healthcare costs—not only from the time when Medicare kicks in at age 65, but before then if you are considering an early retirement.

By 2027, annual medical costs will likely consume more than 60% of the average individual's Social Security income.[3]

Understanding healthcare coverage options before age 65

If you're considering retirement prior to turning age 65, it's important to plan to self-fund medical insurance premiums during the years until Medicare coverage begins.

There are a variety of options available to help you bridge the gap, all of which may increase in cost over time, and should be factored into your retirement income plan.

Employer-provided coverage	• Some firms will allow retiring employees (not yet Medicare-eligible) to continue coverage through the employer's plan. • Coverage may be reduced or premiums increased.
COBRA	• Companies with 20+ employees must offer an extension of benefits (up to 18 months) under COBRA. • Can be very expensive since you're required to take on the full, unsubsidized cost of benefits.
Individual health insurance	• You can opt to purchase an individual policy directly through a private insurer or the Healthcare Insurance Marketplace to cover you and your family. • Premiums vary widely based on insurer and plan details. • For a healthy individual, may be more affordable than electing COBRA coverage.

Estimating expected healthcare expenses from age 65 and older

Even without the threat of a serious illness, out-of-pocket medical expenses are likely to take a significant bite out of your retirement income.

What does Medicare cover?

Plan	Coverage	Out-of-Pocket Costs
Part A (Hospital Insurance)	Inpatient hospital, skilled nursing care, home healthcare, and hospice care	Deductibles, coinsurance and copays
Part B (Medical Coverage)	Doctors' visits, outpatient care, other medical services	Monthly premiums, deductibles, coinsurance and copays
Part C (Medicare Advantage)	Private alternative to Medicare Covering Parts A, B and D	Variable costs determined by Insurer
Part D (Prescription Drugs)	Brand name and generic drugs	Monthly premiums, deductibles and copays

Source: Medicare.gov

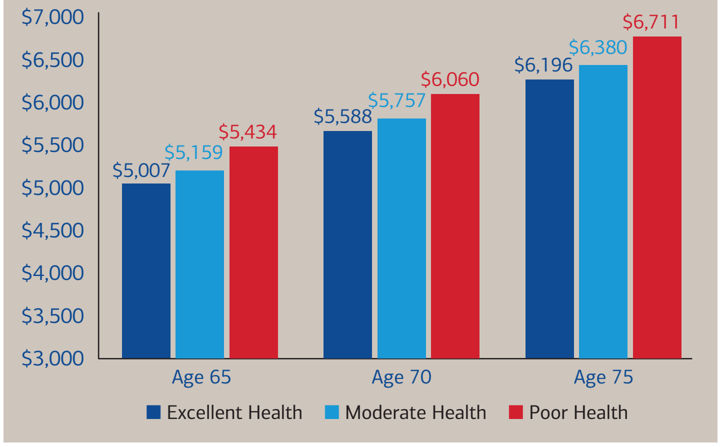
What doesn't Medicare cover?

Although Medicare covers most major costs, with the exception of vision and dental care, the associated out-of-pocket expenses, including monthly premiums for certain program components, deductibles and copayments can quickly mount. You can purchase a "Medigap" supplemental insurance policy to alleviate many of the out-of-pocket deductibles and copayments. But even with supplemental insurance, the most glaring gap remains—Medicare does not cover most of the potentially significant costs associated with long-term care.

How much can I expect to pay out-of-pocket?

Not surprisingly, healthcare costs experienced by retirees vary widely. As the chart on the right indicates, average costs are primarily driven by two variables—your age and the overall status of your health.

Average Annual Healthcare Costs by Age for Individuals on Medicare in 2014



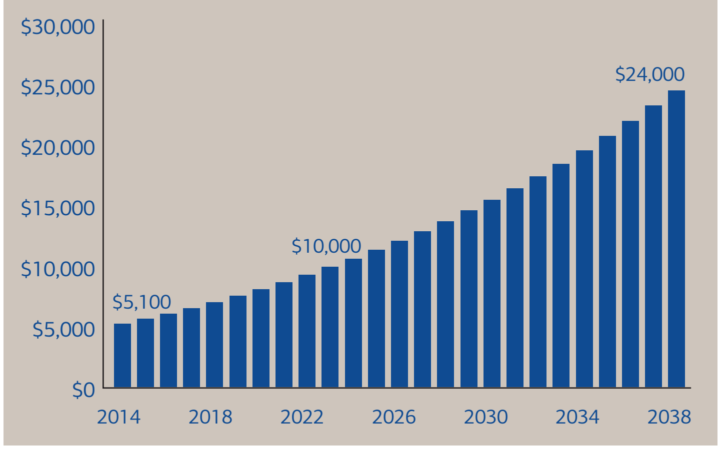
Assumes Medicare Parts A, B and D, as well as Medigap Plan C premium. Includes vision, dental and hearing. Poor, Moderate, Excellent health costs reflect insurance cost data associated with these self-reported health classifications. Health insurance cost estimates provided by HealthView based on historical data and actuarial projections as of November 2013. Conditions that may affect your health status include, but are not limited to cancer, cardiovascular disease, diabetes, high blood pressure and high cholesterol. Smoking may worsen your health status.

The rising cost of healthcare

Over the past thirty years, medical cost inflation has been rapidly outpacing the overall rate of inflation. In fact, since 1982 the overall cost of living has a little more than doubled, while the costs associated with medical care have nearly quadrupled.[4]

This higher inflation means that if you're an average 65-year-old with moderate health who today is paying about $5,100 a year, you can expect to pay close to $10,000 a year at age 75, and nearly $24,000 a year by the time you reach age 89 (see chart below).

65 Year-Old Medicare Beneficiary Annual Projected Healthcare Expenses



Assumes moderate health. Total Healthcare Costs include premiums and out-of-pocket expenses for Part A, Part B, Part D, MediGap, Dental, Vision, Hearing; Source: HealthView Services January 2014.

Anticipating future costs is unpredictable, but a good rule of thumb is to factor in a 9% annual healthcare cost increase for the years prior to age 65, and a 7% annual cost increase from age 65 onward. Your financial advisor can help you calculate these expected costs and identify potential income sources to fund them.

Bridging the long-term care gap with contingency planning

An unexpected healthcare event resulting in the need for long-term care can have a significant impact on your portfolio, potentially depleting your savings and affecting your retirement income.

What constitutes long-term care?

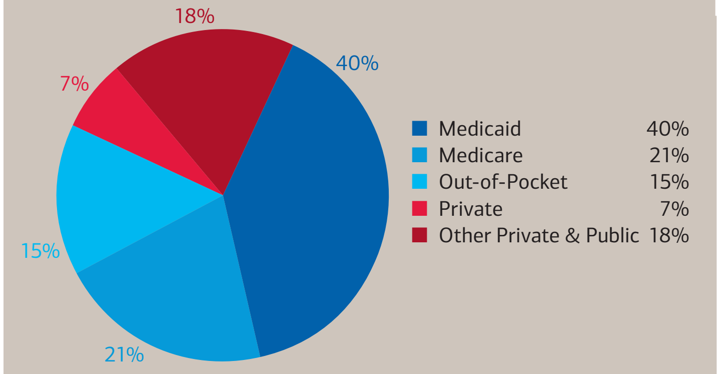
Long-term care consists of those services needed to assist you with the activities of daily living, such as walking, getting out of a chair or bed, eating, toileting or bathing—either in an institutional setting or at home. Long-term care is frequently related to a specific accident, health issue or overall decline in health in old age, including dementia.

What are the costs associated with long-term care?

Considering that the average annual cost for a nursing home stay is $83,950[5] (as high as $255,891[5] in some states), and that the average cost for full-time care (12 hours/day) by a home health aide is $91,000[6] a year, it becomes clear how long-term care costs can quickly wipe out a lifetime of savings.

The average stay in a nursing home is about 2.2 years for men and 3.7 years for women.[6]

Sources of long-term care funding



Source: The Kaiser Commission on Medicaid and the Uninsured, 2011.

Options for funding long-term care costs

There are several options for funding long-term care expenses, including using your own personal assets or depending on family members to provide assistance. The risk of self-insuring is that, depending on how much care you'll need, your long-term care expenses may deplete the assets you have earmarked for other living expenses or for your heirs.

If you're not comfortable taking this risk, you may want to consider transferring some of the risk to an insurance company by purchasing a policy with long-term care benefits. Depending on the policy options you select, insurance can help you pay for the care you need, whether you are living at home, in an assisted living facility or in a nursing home. There are three main types of insurance policies with long-term care benefits you'll want to consider, as outlined on the following page.

Approximately 70% of Americans who are currently age 65 or older will need some type of long-term care.[6]

Insurance policies with long-term care benefits

<table>
<tr><th></th><th>Traditional long-term care insurance</th><th>Hybrid life insurance with a long-term care benefits rider</th><th>Permanent life insurance with a long-term care benefits rider</th></tr>
<tr><td>How it works</td><td>• A policy dedicated to providing benefits if you should need long-term care.
• Premiums are paid over time and are based on the benefits you select when you purchase the policy.</td><td>• A life insurance policy that provides long-term care benefits if you need them.
• If you don’t, an income-tax-free death benefit is paid to your heirs.
• The benefits are set when you purchase the policy and are based on the face amount selected and the money you invest.
• Premiums may be paid over time or all at once in a single premium payment at the beginning.
• A money-back guarantee may also be available through a return-of-premium rider.</td><td>• A life insurance policy that provides a death benefit, but also has a rider which provides access to the death benefit early if you need it to cover long-term care expenses for a permanent health condition.
• Costs and benefits are based on how much life insurance you purchase and a variety of premium payment options are available.
• Unlike traditional long-term care insurance, this type of policy has cash value.</td></tr>
<tr><td>Why it might work for you</td><td>A good choice if you think you’ll likely need long-term care (based on your personal or family health history).</td><td>A good choice if you want to plan for long-term care in case you need it, but also want the flexibility to use the funds set aside for your heirs if you don’t need long-term care.</td><td>A good choice if your primary goal is to get life insurance protection with a death benefit for your heirs—and you’re concerned about paying for long-term care benefits you may not use.</td></tr>
<tr><td>Things to consider</td><td>Your annual premiums may increase and if at any time you stop paying premiums, your policy will be dropped and you will not get your money back. The policy also has no cash value—you forfeit your money if you don’t use the benefits.</td><td>Since the long-term care benefits are limited by the face amount of the policy, they may be less than a traditional long-term care insurance policy.</td><td>Similar to a hybrid policy, the long-term care benefits are limited by the face amount of the policy and may be less than a traditional long-term care insurance policy.</td></tr>
</table>

Your Merrill Lynch financial advisor can help you navigate your options and decide which one best meets your needs. Some of the questions to discuss are:

- *Have you thought about how you’ll pay for long-term care, should you need it?*
- *Will you need to fund all your long-term care, or will a family member help with a portion of your care?*
- *What long-term care costs are you most concerned about?*
- *Do you want coverage for you—or you and your spouse?*
- *Do you want your expenses reimbursed or would you prefer to receive a fixed daily payment?*
- *Do you want to help protect your benefits against inflation?*
- *How do you want to pay for your benefits—over time or upfront?*
- *Are you concerned about paying for benefits you may not use?*
- *Do you need life insurance too?*

Incorporating healthcare costs into your retirement plan

The final step to preparing for healthcare costs in retirement is to integrate strategies that address rising annual healthcare costs, and the costs associated with an unexpected healthcare event, into your overall retirement plan. Your Merrill Lynch financial advisor can help you with this by exploring "what if" scenarios and determining which strategies are most appropriate based on your goals and priorities.

Get started today

As with any type of planning, the sooner you begin to prepare for healthcare costs in retirement, the more options you'll likely have at your disposal. Your Merrill Lynch financial advisor can help you start the healthcare cost planning process by:

- Helping you estimate your expected annual costs, taking inflation into account.
- Reviewing your options for funding long-term care and helping you decide which one best meets your needs.
- Incorporating your total healthcare expenses, both expected and unexpected, into your overall retirement plan.

At Merrill Lynch, we believe that protecting your wealth is just as important as building it. As you navigate to and through retirement, we can help you prepare today to protect your wealth tomorrow.

Contact your Merrill Lynch financial advisor to discuss your healthcare expense planning needs and options, or visit us online at **wealthmanagement.ml.com**.

[1] The Society of Actuaries, 2000 Mortality Table

[2] Employee Benefit Research Institute, October 2013

[3] Fidelity Benefits Consulting, May 2012

[4] U.S. Bureau of Labor Statistics, Table 26, Average Annual Inflation for 2004 -2013 and Americans' Perspectives on New Retirement Realities and the Longevity Bonus Study

[5] Genworth 2013 Cost of Care Survey

[6] National Clearinghouse for Long Term Care Information, U.S. Department of Health and Human Services (www.longtermcare.gov)

This material should be regarded as educational information on Medicare and healthcare costs and is not intended to provide specific healthcare advice. If you have questions regarding your particular situation, please contact your healthcare, legal or tax advisor.

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Long-term care insurance coverage contains benefits, exclusions, limitations, eligibility requirements and specific terms and conditions under which the insurance coverage may be continued in force or discontinued. Not all insurance policies and types of coverage may be available in your state.

Life insurance policies contain fees and expenses, including cost of insurance, administrative fees, premium loads, surrender charges and other charges or fees that will impact policy values. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are a few exceptions, such as when a life insurance policy has been transferred for valuable consideration.

All guarantees and benefits of an insurance policy are backed by the claims-paying ability of the issuing insurance company. **They are not backed by Merrill Lynch or its affiliates, nor do Merrill Lynch or its affiliates make any representations or guarantees regarding the claims-paying ability of the issuing insurance company.**

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