Two actions to tackle health care costs in retirement

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IN BRIEF

Many people do not think about how much health care costs when they are working because they are covered by employer-sponsored health insurance. But that's the time to start preparing for how you will meet these costs when you don't have a regular paycheck. Here are five things to know and two actions you can take to tackle health care costs in retirement:

1. The government and your insurance won't cover everything.
2. An aging population will put pressure on the funding of government systems, which means you may be more reliant on private care.
3. Health care cost inflation outpaces general inflation, which will make health care increasingly more expensive.
4. The use of health care tends to increase with age.
5. Counterintuitively, a long and healthy life may result in higher lifetime health care spending since there are more years of care to fund.

Action items:

1. Factor health care expenses into your overall retirement plan.
2. Invest a portion of your portfolio in growth-oriented mutual funds to keep up with increasing health care costs as you age.

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Health care is one of the biggest expenses in retirement and the toughest to budget. How long will you live? What kind of care will you need? Where will prices be decades from now? If your insurance can't cover everything, how much will you need to fork out of your own pocket? What can you do to support your future health care expenses? Even though engaging in healthy behaviors may keep our average costs lower over time, we cannot know what medical issues we may confront or how long we will live. It is therefore not surprising that in a survey[1] we conducted in Hong Kong, 76% of respondents were worried that health care costs in retirement will put a big strain on their retirement savings.

[1]Source: J.P. Morgan Asset Management, "J.P. Morgan Hong Kong Investor Confidence Index and Retirement Survey," December 2018.

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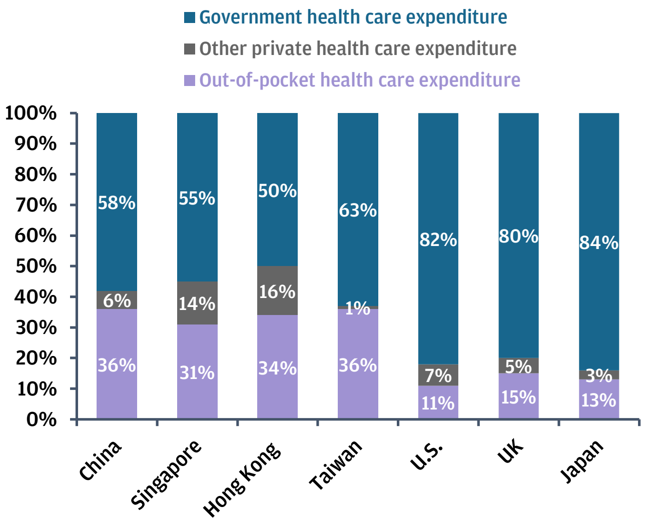
To prepare, here are five things to know about health care costs in retirement and two actions you can take:

Five things to know about health care costs in retirement

1. The government and your insurance won't cover everything: The use of government systems and medical insurance plans may still cause you to incur out-of-pocket expenses, especially if you experience a significant health issue. Also, health insurance premiums paid today may not provide enough coverage for the future. Across China, Singapore, Hong Kong and Taiwan, out-of-pocket health care costs can account for a significant percentage of total health care costs as compared to the U.S., United Kingdom and Japan (see **Exhibit 1**). In addition, the elderly are more likely to pay a greater proportion of total costs out-of-pocket because of the limited availability of elderly health care insurance products[2].

Out-of-pocket health care costs can account for a significant percentage of total health care costs

EXHIBIT 1: TOTAL HEALTH CARE EXPENDITURE BREAKDOWN BY FINANCING SOURCES



Source: Hong Kong Food and Health Bureau (Hong Kong, 2016), Ministry of Health and Welfare[3] (Taiwan, 2016), World Health Organisation[4] (China, Singapore, U.S., UK, Japan, 2016).

A study in Singapore in 2017 found that major health shocks can lead to increases in health care spending by as much as 79%, and the heightened spending is observed up to six months after the shock[5].

According to the Vice Chairman of the National Committee of the Chinese People's Political Consultative Conference, the average treatment costs of common cancer cases in China was 2.1 times that of the average urban resident's annual disposable income in 2014[6]. This puts a tremendous financial burden on cancer patients and their families, especially given the fact that the incidence of cancer increases with age.

2. An aging population will put pressure on the funding of government systems, which means you may be more reliant on private care: In just 30 years, more than one in four people in Asia will be over 60 years old, doubling their share of the total population from 12% to 24%[7]. This rise in the elderly population will increase health care spending, which will create a massive burden on the government and public health budgets in the coming decades. This could also result in longer waiting times at public hospitals. As a result, you may have to use more private care.

Data collected by Hong Kong Hospital Authority showed that the waiting time for stable new cases at specialist out-patient public clinics could be over three years. As an example, the data showed the longest waiting time for orthopedics was reported at 195 weeks[8]. This can have significant implications for older individuals when knee and hip replacements can be more common.

[2]Source: Asia Pacific Risk Center, "Advancing into the golden years - Cost of health care for Asia Pacific's elderly," 2016.

[3]For Taiwan, out-of-pocket payments (OOPs) include reimbursements from private health insurance since such reimbursements are generally made retrospectively.

[4]Out-of-pocket payments are defined as direct payments made by individuals to health care providers at the time of service use. This excludes any prepayment for health services; for example, in the form of taxes or specific insurance premiums or contributions and, where possible, net of any reimbursements to the individual who made the payments. Other private health expenditures include voluntary health insurance.

[5]Source: Cheng, T., Vaithianathan, R. and Li, J., "Monthly Spending Dynamics of the Elderly Following a Health Shock: Evidence from Singapore," July 2018.

[6]Source: National Committee of the Chinese People's Political Consultative Conference website, February 27, 2019.

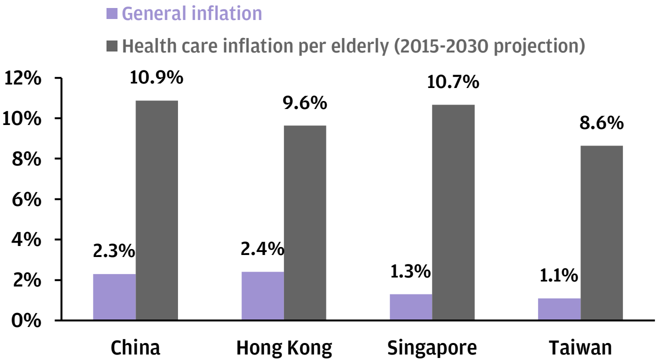
[7]Source: United Nations, Department of Economics and Social Affairs, Population Division (2019). World Population Prospects: The 2019 Revision.

[8]Source: Hong Kong Hospital Authority website, 1 July 2018 - 30 June 2019. The longest (90th percentile) waiting time implies that appointments are earlier than the indicated time in 90% of the new case bookings.

3. Health care cost inflation outpaces general inflation, which will make health care increasingly more expensive: Health care inflation is much higher than general inflation (see **Exhibit 2**), which means that health care expenses will rise faster than other expenses. This health care inflation is primarily driven by advancements in medical technology such as new therapies and drugs. Of course, an aging population that increases demand for the same supply and a changing disease profile also have roles to play here[9]. A prudent approach to retirement planning should anticipate higher increases in health care cost.

Expect health care inflation to outpace general inflation

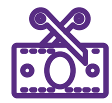
EXHIBIT 2: HEALTH CARE INFLATION VERSUS GENERAL INFLATION



Source: Asia Pacific Risk Center, 2016; International Monetary Fund, World Economic Outlook Database, April 2019; J.P. Morgan analysis. Health care inflation is based on higher end projections of health care cost per elderly in 2030. The health care cost takes into account government spending and not just out-of-pocket expenses.*

4. The use of health care tends to increase with age: Retirees tend to consume significantly more health care as they get older. A U.S. study stated approximately half of lifetime medical expenditure are incurred after the age of 65[10]. Health care costs will become a significant and growing part of your total expenses in retirement (see **Exhibit 3A** & **3B**).

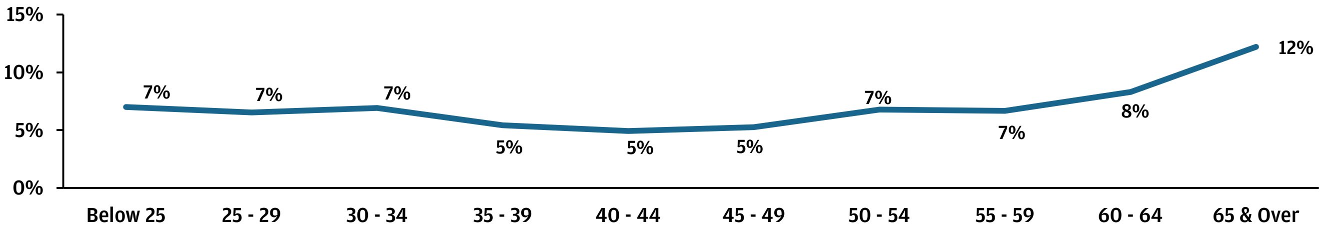
In a survey we conducted in Hong Kong, 76% of participants indicated they are worried that health care will become their biggest retirement expense, and 67% are worried about the cost that will be incurred by long-term care[11]!



5. A long, healthy life may result in higher lifetime health care spending since there are more years of care to fund: Depending on your family medical history and lifestyle, you may live longer than average—and incur expenses over more years in retirement. Counterintuitively, even if you are healthy and your annual health care costs are lower, the longer you live the higher your aggregate lifetime health care expenses may be since there are more years of care to fund. Importantly, more intensive use of care may be decades away when prices are higher, resulting in high lifetime costs. Women typically live longer than men, so they may face more years to fund as well as a greater likelihood of needing to pay for long-term care.

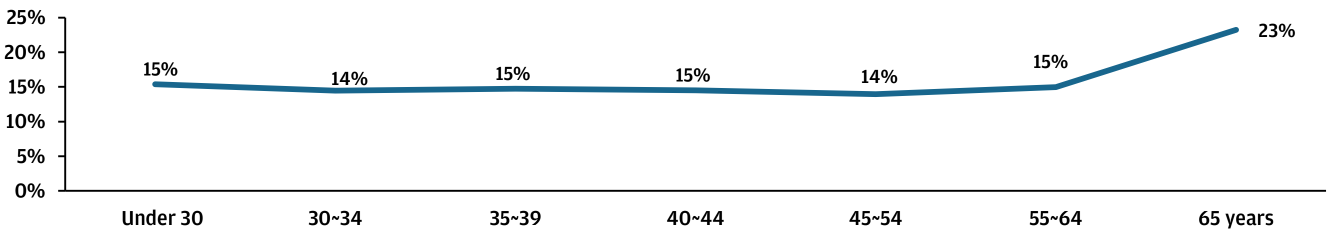
Health care costs tend to increase with age

EXHIBIT 3A: SINGAPORE HEALTH CARE COST EXPENDITURES AS % TOTAL EXPENDITURES



Source: Department of Statistics Singapore, "Household Expenditure Survey," 2017-2018.

EXHIBIT 3B: TAIWAN HEALTH CARE COST EXPENDITURES AS % OF TOTAL EXPENDITURES



Source: National Statistics, Republic of China (Taiwan), "The Survey of Family Income and Expenditure," 2018.

[9] Source: Nomura Global Markets Research, "Asia Pacific hospitals: Technology investments to drive growth," 2018.
[10] Source: Alemayehu, B. and Warner, K., "The lifetime distribution of health care costs" Health Services Research 39 (3): 627-42, 2004.
[11] Source: J.P. Morgan Asset Management, "J.P. Morgan Hong Kong Investor Confidence Index and Retirement Survey," December 2018.

Two actions you can take to tackle health care costs in retirement

1. Factor health care expenses into your overall retirement plan

As you build your retirement plan, factor in health care costs while bearing in mind all the aforementioned considerations. We suggest consulting with a financial advisor to conduct a financial analysis, so you can clearly see how medical costs impact your overall financial picture. Do you have your basic insurance needs covered? Consider your options as early as feasible, since coverage may be more expensive or unavailable if you wait. Given that your insurance may not cover everything, it is important to supplement your insurance with savings and investment strategies to support your future health care expenses.

2. Invest a portion of your portfolio in growth-oriented mutual funds to keep up with increasing health care costs as you age

Given increasing costs due to both health care specific inflation and increased use of care with age, it is vital to invest over the long term for growth regardless of where you are in your retirement journey. That involves the design of investment portfolios aimed at outpacing health care cost increases and bolstering funds for unexpected health care expenses. As you shift into retirement, it is natural to prioritize income, but growth is equally important to keep up with the growth of health care costs. This means investing a portion of your portfolio in equities for the long term. Growth-oriented mutual funds could be leveraged to capture growth opportunities efficiently to help cover future health care expenses.

Conclusion

We can engage in healthier behavior that may lower our future health care bills. Still, we cannot know what medical issue we may confront or how long we will live. We do know that older people tend to use more health care than their younger counterparts and that health care expenses will be subject to a higher inflation. This makes it critical to talk to a financial advisor to factor health care expenses in to your overall retirement plan, and invest a portion of your portfolio in growth-oriented mutual funds to keep pace with the rising costs of health care.

***Disclaimer**

Marsh & McLennan Companies Asia Pacific Risk Center, 2016.

The sensitivity analysis conducted for this study varies each of the key modelling cost drivers to project the elderly health care expenditure: (1) demographic effects, (2) inflation rates, (3) long-term care utilization and (4) medical trend, determining to what extent these results are sensitive to substantial but plausible variations in any parameters, as well as judging the robustness of the model conclusion.

- When projecting future population, demographers often generate a series of high, median and low projections, each of which assumes different fertility and mortality rates. In the modelling study, the median values projected by the UN Population Division are chosen to reflect the current conditions, while the upper and lower 95% confidence interval values around the median are selected to reflect the possible range of future projections.
- Besides projecting future population growth rates, future inflation rates or any other economic variables are often estimated with uncertainty and may not be known with great precision. Hence, similar high and low projections calculated from the upper and lower 95% confidence level values are used to understand the potential variance in the outcome should the estimated inflation rates deviate from expectations.
- Variable-specific assumptions are applied to LTC coverage in the sensitivity analysis to better assess the robustness of the modelling outcome. In this sensitivity analysis, the low projection assumes no additional costs injected into developing LTC infrastructure or encouraging LTC utilization, and that the LTC coverage rate remains at its 2015 levels through to 2030 for every market modelled. On the other hand, in the high projection sensitivity analysis, we assume every market aspires to provide the same level of LTC coverage as Australia, the highest provision of LTC concluded in this study, and are able to financially achieve this by 2030.
- In the dataset used in this study, the medical trend variable takes on the 2016 expected medical inflation rates surveyed by MMB and are assumed to remain constant throughout the modelling period. Similarly to projecting future population growth and inflation rates, high and low expected medical trend values assume the upper and lower 95% confidence intervals values. Mercer Marsh Benefits, 2016. Medical Trends around the World 2016. Global: Mercer Marsh Benefits.

NEXT STEPS

For additional information, please contact your J.P. Morgan Asset Management representative.

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