Under The Hood: Medicare Parts A, B, C and D—What You Need to Know, Pt. 1

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A primer on the four different parts of the Medicare system.

This is one in a series of Under the Hood articles that provides insight into common issues faced by advisors and their clients.

Medicare was created through *Title XVIII of the Social Security Act* in 1965 and became effective in 1966. This program, administered by the federal government, was originally created to provide medical coverage for qualifying individuals 65 and older and the disabled. However, I suspect that no one at that time predicted the medical advancements which were to come and the longer life expectancies which ensued.

In this article, we'll discuss the various parts of Medicare, some of its history, and the provisions of Medicare Parts A, B, C and D.

The History (and Side Effects) of Medicare

In the beginning, Medicare was a bit more than a social health insurance program. It also played a role in the racial desegregation of America because payment to medical providers was conditional. In short, if the medical provider refused to accept minorities, the government refused to pay the provider.

Over the past 48 years, Medicare has added several illnesses to its coverage including hospice care in 1982 (made permanent in 1984); speech, physical and chiropractic therapy in 1992; and ALS (i.e.; Lou Gehrig's disease) in 2001, to name but a few. However, as mentioned, with the longer life expectancies experienced by the population since its inception, Medicare and Medicaid (i.e.; state insurance for the poor) have become the largest item (combined) in the federal budget today, with an estimated cost of over $900 billion per year and rising. Medicare alone cost about $492 billion in 2013.

In 1967 when the House Ways and Means Committee published its projected cost of Medicare in 1990, it figured it would be $12 billion. The actual cost that year? A staggering $98 billion.

How to Qualify

Medicare covers those aged 65 and older, along with younger persons with disabilities and end-stage renal failure. To qualify at age 65, a person must have been a U.S. resident for at least five years and they or their spouse must have paid Medicare taxes for at least 10 years.

Medicare Part A

Medicare Part A covers in-patient hospital expenses (with limits); skilled nursing care and nursing home care (under certain circumstances and with limits), and hospice care. As for the limitations to coverage, there is a limit of 90 days per stay in a hospital, plus a coinsurance. During the first 60 days there is no coinsurance. However, from day 61 to 90, the individual is responsible for a co-pay of $304 per day. From the 91st day on, the coinsurance is $608 per each "lifetime reserve day" up to a maximum of 60 days total over the individual's lifetime.

To clarify, a lifetime reserve day is any day over the first 90 days of an individual's lifetime. For example, if a Medicare patient were in the hospital for 100 days during one hospital stay, the last 10 days would be considered "lifetime reserve days" leaving the person with 50 of these days to use over their lifetime. The point here is that Medicare Part A has some potentially expensive gaps which is why a person should purchase a Medicare supplement plan (or see *Medicare Part C* below).

Medicare Part B

Medicare Part B is optional and covers outpatient expenses such as lab tests, outpatient surgeries, doctor visits and limited outpatient prescription drugs (typically not drugs you would administer yourself). Coverage begins after meeting an annual deductible of $147 (2014). After meeting the deductible, the individual must also pay a coinsurance of 20% of the Medicare-approved charges for services and drugs.

Medicare Part C

Medicare Part C is not actually a separate coverage, but is the part of Medicare which allows private health insurers to create Medicare replacement policies. In short, an individual may elect to purchase one of these plans in lieu of Medicare and a supplement.

In the past, an individual with Medicare would often buy a Medicare supplement to cover procedures or illnesses which Medicare did not cover. However, when Congress passed the *Balanced Budget Act of 1997* it included a provision to allow what was originally called *Medicare +Choice* or *Part C* plans.

When Congress passed the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003*, the name of these plans was changed to Medicare Advantage plans. Therefore, Medicare Part C created the Medicare Advantage plan which is an option that can be purchased in lieu of traditional Medicare. Normally, these plans are fairly comprehensive in coverage.

Medicare Part D

This is the newest part of the Medicare program and covers prescription drugs. Moreover, it is also available to anyone with Medicare. There are two ways to obtain Medicare Part D coverage. They are:

1) Join a plan run by an insurance company or other private company approved by Medicare; or

2) Purchase a Medicare Advantage plan which covers prescription drugs (see Medicare Part C above).

Medicare Part D covers prescription drugs up to a maximum of $2,970 per year.

To find a Medicare Part D program, you can view the Medicare choices online or call 800-633-4227.

Conclusion

Medicare has become an integral part of the American fabric. Millions of individuals rely on it to pay for what has become a significant expense in their budget. As health care costs continue to rise, and life expectancies lengthen, it's clear that some action will need to be taken to preserve this important program.

I don't think many of the original legislators from 1965 could have imagined how costly Medicare would become and I doubt many of us today can fully appreciate the coming mushroom this program will create as the baby boomers cycle through the retirement turnstile. One thing seems certain, no politician or political party wants to be known as the party that killed Medicare.

In the next article in this Under the Hood series, we'll discuss the premiums for Medicare and the changes in the program as a result of the Affordable Care Act.

Under the Hood: Medicare Premiums—What You Need to Know, Pt. 2

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Understanding the premiums for Medicare parts A, B and D, and some changes from the Affordable Care Act

In the initial post in this two-part series looking Under the Hood on Medicare, Medicare Parts A, B, C and D—What You Need to Know, we presented a primer on the four different parts of the Medicare system and their origins, growth, options and costs.

This week we'll focus on Medicare premiums, which I believe are quickly becoming an integral part of the financial planning process; each advisor should have at least a cursory understanding of the cost of the program.

Medicare Part A Premiums

As mentioned, this part of Medicare covers inpatient hospital, skilled nursing care, and nursing home and hospice care, within limits. Moreover, it is free to those who qualify for Medicare (i.e.; paid into Medicare for at least 10 years). This includes a spouse of those who have paid into Medicare, even if the spouse hasn't paid into the system.

If an individual is not eligible for free Part A, they may still purchase it by paying a premium up to $426 per month. Moreover, if you don't qualify for free Part A, and you don't buy it when you first become eligible, you may be subject to a penalty equal to a 10% increase in the monthly premium.

For example, if you were eligible for Part A two years ago and you enroll today, you would pay the higher premium for two times the period for which you were eligible but not enrolled. Hence, the higher premium would last four years. There are, however, some exceptions which are beyond the scope of this article.

One final note on Part A. If you choose to buy Part A you must also purchase Medicare Part B.

Part B Premium

This is the portion of Medicare which covers outpatient services and is optional. It should be noted that your premium for Part B will be based, in some cases, on your income from as many as two years. For example, if you became eligible for Medicare in March 2014 and enroll in Part B, assuming you hadn't filed your 2013 tax return by then, Medicare would use your income tax return from 2012 to determine your premium. Hence, if your retirement income is much lower than your income while working, your Part B premium may cost you more than you anticipated.

The premium is based on income and, just like Medicare Part A, if you fail to enroll in Part B when first eligible and do not have a valid exception (again beyond the scope of this article), you may be subject to a penalty which is much more onerous than the penalty from Part A.

In short, the penalty is a 10% premium increase for each full 12-month period you are late in enrolling. Hence, if you were 38 months late (three full years plus two months), your premium will be 30% higher for as long as you have Part B.

The following table displays the cost of Medicare Part B and Part D which we'll discuss in the next section.

Medicare Part B & Medicare Part D Premiums			
Monthly Plan Premium (PP) *(Part B)*	*Annual Income* [1]		Monthly Premium *(Part D)*
	Single	Married	
$104.90	< $85,000	< $170,000	Your plan premium (PP)
$146.90	$85,001 to $107,000	$170,000 to $214,000	PP + $12.10
$209.80	$107,001 to $160,000	$214,000 to $320,000	PP + $31.10
$272.70	$160,001 to $214,000	$320,001 to $428,000	PP + $50.20
$335.70	$214,001 +	$428,001 +	PP + $69.30

[1] *Based on MAGI (AGI plus tax exempt interest income)*

Part D Premium

This part of Medicare covers prescription drugs and is available to anyone eligible for Medicare. In my last post on Medicare I included a link to the Medicare Plan Finder. This tool will allow you to select the Part D plan which suits your needs. As mentioned, one way to purchase this coverage is through a Medicare Advantage plan under Medicare Part C. Refer to the table above for the monthly premium. According the Medicare, most people won't have to pay a higher premium for Medicare Part D.

Medicare Changes From the Affordable Care Act

With the implementation of the Affordable Care Act, aka Obamacre, several preventative medical procedures are now covered under Medicare with no deductible or coinsurance. These include items such as mammograms, colonoscopies, cancer screenings and yearly "Wellness" visits. In addition, there are lower prices on many covered brand-name drugs.

Another change affected by the Affordable Care Act has to do with the so-called prescription drug "donut-hole." Since Medicare Part D covers up to $2,970 per year for prescription drugs, an individual will pay a co-pay of 47.5% for brand name drugs and 79% on generics when their total prescription drug bill exceeds the annual maximum. This gap will be closed by the year 2020. After that, individuals will pay a flat 25% for all prescriptions, brand name or generic.

If you have a Medicare Advantage plan, you may experience some differences between it and original Medicare (some better, some worse). Under the ACA, Medicare will be paying less to some Medicare Advantage plans. As a result, some plans may cut benefits such as dental care or increase coinsurance requirements. You should check with your particular Medicare Advantage plan for details.

Finally, prior to the new law, when a patient had a surgical procedure, each medical practitioner involved would send a bill for their services. This is known as a fee-for-service model. Under the new law, the payment will be bundled. The expectation is that a bundled system will help reduce waste and unnecessary charges as each "episode of coverage" will be reimbursed according to a pre-determined schedule. Will this work as planned? We shall see.

Future Viability of the Program

Medicare is one of the largest items in the federal budget with projected costs expected to reach $858 billion by 2024. That equates to about 30% of today's federal revenue. Therefore, unless we grow our economy (which would increase tax revenue), we may be looking at a hefty tax hike down the road.

That is, unless Washington takes some sort of action such as raising the Medicare withholding tax percentage or the age of eligibility.

In general, this entitlement is only one of many which cause economists to worry that we are on a fiscally unsustainable path. According to one Federal Reserve President with whom I spoke recently, the current fiscal deficit is improving. However, it will begin expanding around 2020 when entitlements will cause stress to the budget.