Bridging the Gap: How to Pay for Healthcare When Retiring Early

For many, early retirement is the ultimate dream scenario – having the financial freedom to pursue your passions while you're still young enough to enjoy them. If you're thinking of retiring before age 65, though, you'll need a plan for paying for healthcare before Medicare coverage kicks in. Fortunately, you have several options at your disposal.

Option 1: Continuing Your Current Employer Coverage

There once was a time when employers would regularly offer health insurance benefits to retirees. While many companies have eliminated that benefit, some larger companies still offer it. If your employer doesn't, it might be worth discussing a formal phased retirement strategy that considers how many hours you're willing to work and your healthcare needs pre-retirement. Companies that value your years of service, institutional knowledge and willingness to facilitate a smooth transition might be receptive to this idea.

COBRA provides another means of extending your retirement benefits after leaving your employer. The Consolidated Omnibus Budget Reconciliation Act requires employers with at least 20 employees to extend coverage for 18 months – or even, in some circumstances, 36 months – after employment. In addition to that coverage cap, COBRA's main downside is that you lose the employee subsidy, which means you would need to pay 100% of the annual premium plus a 2% administration fee. In 2018, the average annual premium (employer + employee) amounted to nearly $20,000 per employee, according to the Kaiser Family Foundation.

Option 2: Enrolling in the Affordable Care Act

Enacted into law in 2010, the Affordable Care Act is designed to make health insurance available to more people, particularly those who are ineligible for an employer plan. The ACA created a health insurance marketplace where anyone looking for coverage can shop for and enroll in state or federal medical insurance plans, often with significant federal subsidies to keep prices down.

While typically you would have to wait for November's open enrollment to buy a policy, retirement is considered a "qualifying life event" that allows you to get coverage right away. You can explore different policies at healthcare.gov.

Most insurance providers also offer short-term coverage plans outside ACA's health insurance marketplace. While these plans are typically far less expensive than what you might find within the ACA, their coverage tends to be more limited – they generally don't cover pre-existing conditions, mental health, preventative care or prescription drugs. Importantly, while there currently is no federal tax penalty for not having health insurance, it's possible that enrolling in a short-term plan that isn't ACA-compliant will result in a state tax penalty, depending on where you live.

Option 3: Working Part-Time

There are multiple reasons why part-time work might make sense for someone who's retired – it can allow you to boost your retirement savings, forge new relationships and pursue an activity you're passionate about. It could also be a way to obtain health insurance. Many employers offer health insurance and other benefits to part-time employees. You might need to meet certain thresholds (such as months at the company or a minimum number of working hours per week) and accept a lesser income than you're used to, but for many older workers, the health coverage is more valuable than the salary.

There are other, smaller ways you can mitigate healthcare costs before Medicare kicks in, such as taking advantage of your employer's health savings account benefit, increasing your cash reserves, exploring your spouse's plan requirements and even improving your eating and activity habits. Your Baird Financial Advisor is a great sounding board for how to fold healthcare expenses into your broader retirement plans.