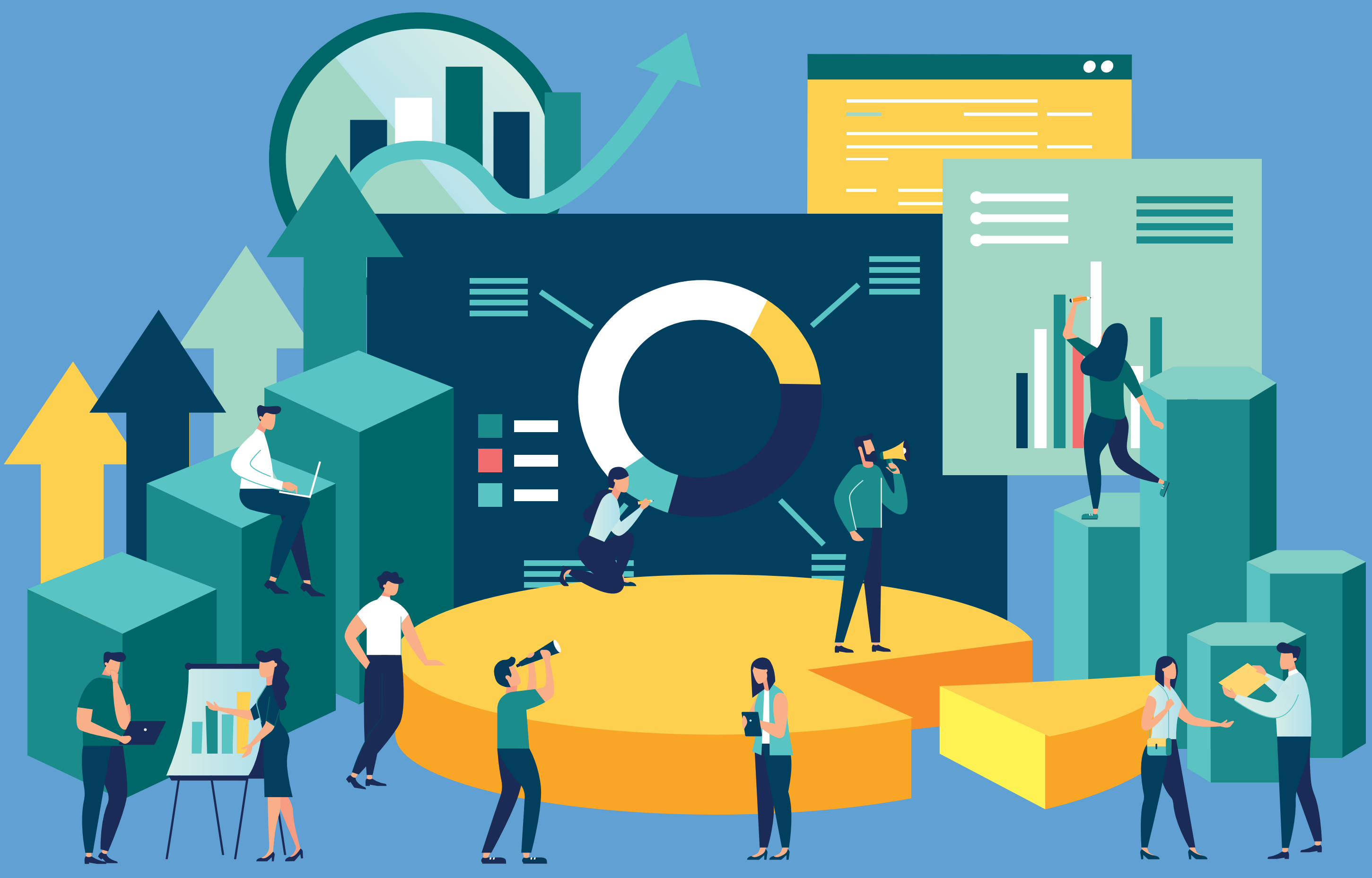
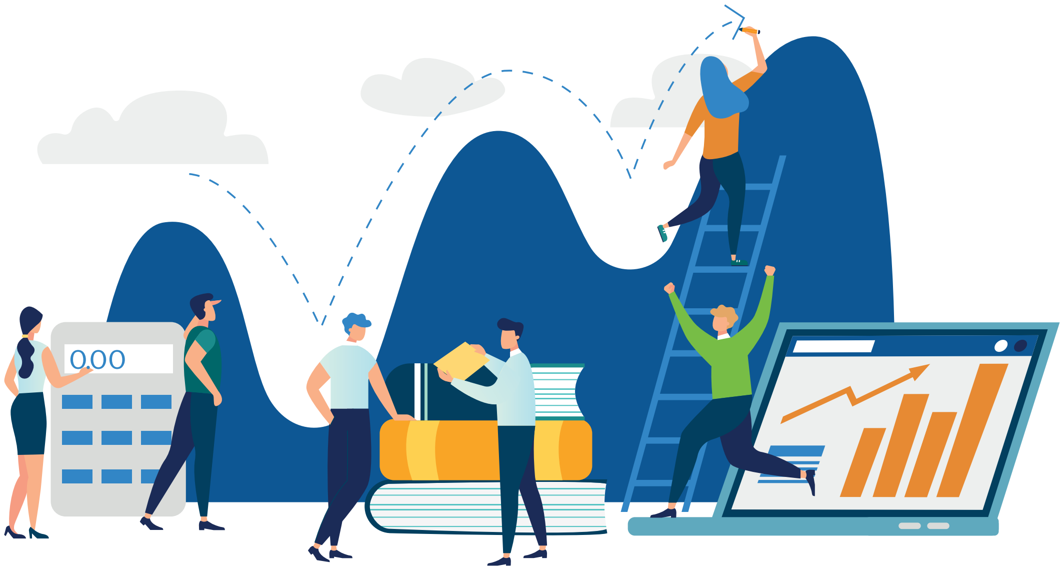
HealthView SERVICES

# The Long-Term Value of an HSA

*The most effective solution for funding healthcare costs in retirement*






# Triple-Tax Savings Make HSAs the Top Strategy to Prepare for Future Health Costs

Healthcare costs, despite many strategies to rein them in, continue their relentless climb, growing an average of more than 5% annually. This rate is well ahead of wage growth which is estimated to be 4% over the next 10 years[1]. As America's Baby Boomers surge into and through retirement, they are presenting evidence[2] that the high cost of healthcare while on a fixed income is problematic for millions of older Americans.

## Projecting Future Health Costs

The generations that trail in the turbulent wake of the Boomers are heading into this same healthcare cost storm and – aside from hoping for perfect health -- many don't have a retirement savings plan that takes these costs into consideration.  And yet, two stark realities exist:

- A healthy 65-year old couple can expect to spend just over $600,000 in future lifetime healthcare costs. Costs are larger for younger healthy couples due to longer exposure to inflation.[3]
- Surveys routinely show that even though health issues are the leading concern of retirement age adults, nearly half of the people surveyed do not have a plan to address those costs.[4]

While the costs are staggering, and the volume of older Americans who are unprepared for the storm is deeply concerning, solutions are available. Everything needed to change this worrisome set of circumstances is available to employers, financial advisors, banks, life insurers, and retirement and HSA plan providers/record keepers so they can help guide their employees, customers or plan participants.

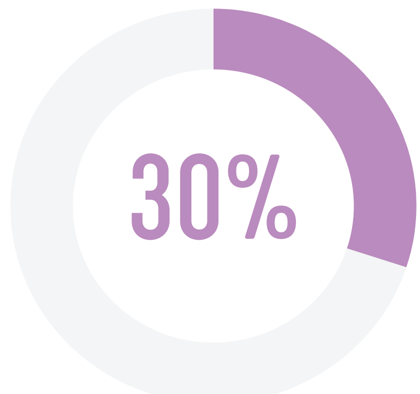
- The ability to see and use data to access personalized retirement health costs based on simple demographic and health information;
- The ability to assess the gap between existing projected retirement savings, and what will be needed if healthcare costs are fully factored in;
- And a variety of financial tools to assist adults in affordably closing the gap.

For purposes of this discussion, the focus here will be on the Health Savings Account, or HSA, which is by far the most tax-advantaged plan for retirement healthcare cost savings, and yet dramatically underutilized to its full potential.

## A Third of Americans Have Access to an HSA

HSAs are paired, under law, with high-deductible health plans (HDHPs). They are not available with other plan designs such as indemnity, PPO or HMO plans.

Approximately 30% of Americans are currently enrolled in HDHPs, and that number has grown significantly over the last several years.  In the 10 years through 2017, enrollment in high-deductible health plans with an HSA grew from 4.2% to 18.9%—a 350% increase—among adults aged 18–64.[5]




3 in 10 Americans are currently enrolled in a high deductible health plan.

That growth is unsurprising, given that many large firms have promoted high deductible plans due to their lower premiums and their overall dampening effect on healthcare spending. The National Bureau of Economic Research (NBER) found that employers that offered high deductible plans over a three-year span were successful in reducing company healthcare expenditures.[6]

These savings are possible for employers because HDHPs are designed to bring out the consumer in the patient. They do this by making the employee's wallet a larger part of paying for healthcare and thus arousing the consumer instinct to seek lower cost, high value healthcare. With this pressure on health costs, the goal is that competitive market forces will assert themselves and bend the cost curve.  However, not every patient is a consumer – those with acute or chronic care needs generally require expensive care. And many employees struggle to afford the deductibles and cost sharing in these plans, which can lead to unhealthy behaviors. No effort should be inferred from this paper that rationing necessary care today to afford savings for tomorrow is suggested. All people in an HDHP must prioritize their health today, or the remainder of this discussion is a moot point.

# Rethinking the HSA

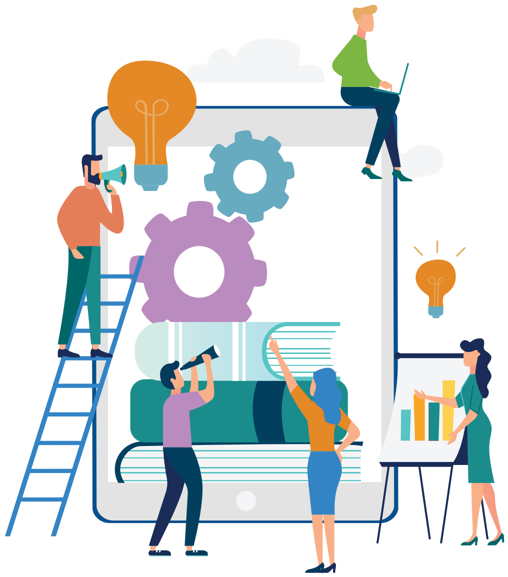
For people who can reasonably afford their plan's annual deductibles, which average about $2,500 for an individual and $4,700 for a family[7] as well as other cost sharing in the plan (which may be several thousand[8]) the HDHP is a solid benefit solution that encourages healthy behaviors. And it comes with a lifelong, portable silver lining: the HSA. Used properly, the HSA may be able to fund a significant portion of projected health costs in retirement.

Americans need to rethink and reframe the HSA. Healthcare coverage is an annual benefit tied to the employer. An HSA is a life-time product tied to the individual. **It does not need to be used in the health benefit plan year, and it should not be, if possible.** Even though the HSA comes with the health benefit plan, it actually should be viewed through the same lens as a retirement planning tool like a 401(k) or 403(b). HSAs are, due to the virtually tax-free status they uniquely claim, **one of the best ways to stretch retirement savings.**

HSAs have a triple tax benefit. First, the money goes into the account pre-tax. (And a portion of the contribution may come from the employer.) Second, once the HSA balance reaches $1,000, it can be invested, and growth is tax-free. Third, in retirement (or before if necessary) **money used for health expenses comes out tax-free.**

**The HSA Advantage**

- Contributions are pre-tax
- Growth is tax-free
- Withdrawals on qualified medical expenses are tax-free



Remember: withdrawals from a traditional 401(k) plan are always taxed as income, but HSA withdrawals for health expenses are tax free. To place this in context, consider $100,000 has been saved in both a traditional 401(k) and in an HSA. Both accounts have been funded with pre-tax dollars and have grown tax free. But with the triple-tax benefit of the HSA, the full $100,000 is available to withdraw tax free for health expenses. Conversely, in the traditional 401(k) and assuming a 24% tax rate, only $76,000 is left after taxes to pay for health or any other expenses.

Lower contribution limits to HSA accounts means employees still should take advantage of 401(k) plans, at a minimum to the level of the employer's match. However, paying for your healthcare in retirement with an HSA fund reduces the tax burden and stretches retirement dollars dramatically.

This approach does require a change in thinking for individuals who use their HSA as a health "spending" account, versus a health "savings" account. It means the hard truth of not using the employer contribution in any given year, making individual contributions to the highest possible level, and letting the fund grow over time.

This methodology suggests individuals should:

1. First, contribute to a 401(k), or other employer-sponsored retirement plan, up to the company match amount. Often, employers match either 50% or 100% of an employee's contributions up to a certain limit. For the employee, this is part of their compensation package and an investment in their future.

2. Next, max out the HSA. For 2020, total HSA contributions (inclusive of what an employer funds) are capped at $3,550 for 2020, or $7,100 for couples. With compounding and continued savings, these savings will set the course for less worry about healthcare in retirement.

3. Finally, if more money is available for savings, individuals should maximize traditional retirement vehicles such as a defined benefit plan or other savings options. For 2020, individuals can save up to $19,500 on a pretax basis, which is enough to push some people into a lower tax bracket and provide an amazing head start on retirement wealth accumulation.

## In the Benefit Alphabet Soup, Making the Case for the HSA

Arguably, the HSA is poorly understood by many employees, and more should be done to educate people on how they work, and how they should be used. That education can be provided in a number of different ways – directly by employers, by HSA record keepers or retirement plan providers, by financial advisors, accountants, banks or life insurers, especially if participants have access to personalized healthcare cost and funding projection software. Consider that:

- One of the country's largest retirement services providers conducted a study of plan participants and the results are telling. Those who were shown individualized projected costs of their healthcare in retirement increased deferrals by 25%.

- Data demonstrates that modest, consistent HSA contributions may fund a significant portion of workers' eventual retirement healthcare costs (see case below).

- People like and use online calculators. Many employers offer calculators that enable individuals to estimate healthcare costs for the next benefit year. Many 401(k) plan administrators offer calculators that help individuals project their retirement savings. Data is available to fuel calculators that project future healthcare costs.

# An HSA in Action

To understand how HSAs can make an impact on healthcare spending in retirement, consider the case of Jason, a hypothetical unmarried 45-year-old with well-managed high cholesterol. He participates in an employer-sponsored HDHP and earns a 6% average annual return on his HSA, to which his employer contributes $500 annually. To meet the 2020 maximum contribution amount, Jason is eligible to personally fund an additional $3,050. Like most employees, Jason pays his health insurance premiums via payroll deduction. He withdraws a modest amount to meet out-of-pocket expenses during the year. He plans to retire at age 65 and to rely heavily on his HSA to fund his healthcare expenses in retirement.

### Table A: Jason's Projected HSA Savings Value at Retirement

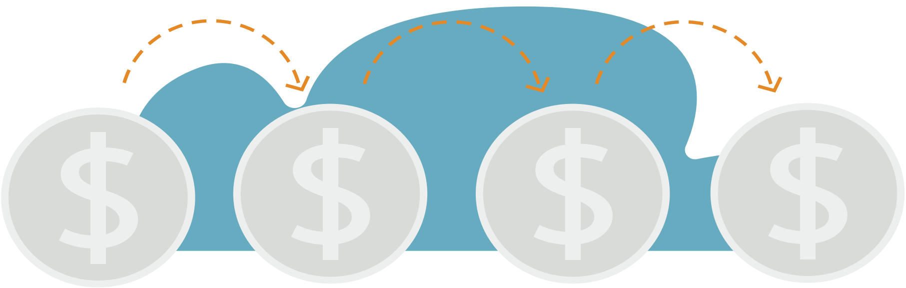
| Jason's Contribution* | HSA Balance at Retirement** |
| --- | --- |
| Contributes $1,000/year | $42,683 |
| Contributes $2,000/year | $79,468 |
| Contributes Maximum | $118,093 |

**Jason's contribution amounts do not include $500 annual employer contribution. "Maximum" does not include the $1,000 "catch-up" contributions that are available from age 55 to 64.*

***Assumes Jason spends an average of $359 in HSA funds annually on out-of-pocket health expenses and saves the rest. Spending figures are based on typical health costs for a Colorado resident with these demographics. Healthcare costs in Colorado are approximately average among the 50 states. Growth in Jason's HSA portfolio assumes a 6% rate of return per year.*

Jason consistently contributes the maximum to his HSA (in 2020, that's $3,050: $3,550 minus the $500 his employer covers) and withdraws an average of less than $400 a year to cover out-of-pocket healthcare spending needs. In this scenario, he could generate more than $118,000 in tax-free savings by his retirement at age 65.  At that point, he will enroll in Medicare, which will still involve substantial out-of-pocket healthcare costs. But Jason will be able to withdraw an average of approximately $8,636 per year from his HSA in retirement to help meet those expenses (see Table B).

In this scenario, he could generate more than **$118,000** in tax-free savings by his retirement at age 65.



### Table B: HSA Withdrawals to Subsidize 20 Years of Retirement Healthcare Costs*

| Age | Year | Total Health Costs** | HSA Withdrawal | % of Costs Covered |
|---|---|---|---|---|
| 65 | 2040 | $4,931 | $4,931 | 100% |
| 66 | 2041 | $5,336 | $5,336 | 100% |
| 67 | 2042 | $5,765 | $5,765 | 100% |
| 68 | 2043 | $6,219 | $6,219 | 100% |
| 69 | 2044 | $6,704 | $6,704 | 100% |
| 70 | 2045 | $7,219 | $7,219 | 100% |
| 71 | 2046 | $7,765 | $7,765 | 100% |
| 72 | 2047 | $8,349 | $8,349 | 100% |
| 73 | 2048 | $8,974 | $8,974 | 100% |
| 74 | 2049 | $9,641 | $9,641 | 100% |
| 75 | 2050 | $10,338 | $10,348 | 100% |
| 76 | 2051 | $11,101 | $11,101 | 100% |
| 77 | 2052 | $11,897 | $11,897 | 100% |
| 78 | 2053 | $12,736 | $12,736 | 100% |
| 79 | 2054 | $13,621 | $13,621 | 100% |
| 80 | 2055 | $14,561 | $14,561 | 100% |
| 81 | 2056 | $15,562 | $15,562 | 100% |
| 82 | 2057 | $16,619 | $11,992 | 72% |
| 83 | 2058 | $17,859 | $0 | 0% |
| 84 | 2059 | $19,170 | $0 | 0% |
| **Total** | | **$214,376** | **$172,719** | -- |
| Average | | $10,719 | $8,636 | 89% |

**Includes Medicare Part D, Medigap Plan G, and out-of-pocket costs such as hospitalization, doctor visits and tests.*

***Assumes Medicare Part B premiums are deducted from his Social Security checks.*

Table B provides a powerful demonstration of how an HSA can be used to offset retirement healthcare costs. With his HSA, Jason will cover the entirety of his health spending through age 81, and 89% of his lifetime spending overall[9]. In addition, he will avoid being taxed on more than $170,000 of his assets. Few other savings plans can create this level of net income with such a modest pre-retirement investment.

If Jason were to choose a 401(k) as his healthcare funding source instead of the HSA, he would have to withdraw $227,245 (nearly $55,000 more) because it is taxed, just to get the net income high enough to cover 89% of costs.

By funding his healthcare costs with an HSA, Jason saves **$54,526** in taxes on his withdrawals.

# HDHPs and HSAs: a Potential Win/Win for Companies and Their Employees

Aside from living in perfect health, no proven solution for reducing medical-related expenditures exists. With health costs continuing to rise, paying for healthcare must be viewed as a personal, lifelong financial responsibility, and Americans should assume greater ownership of the process.

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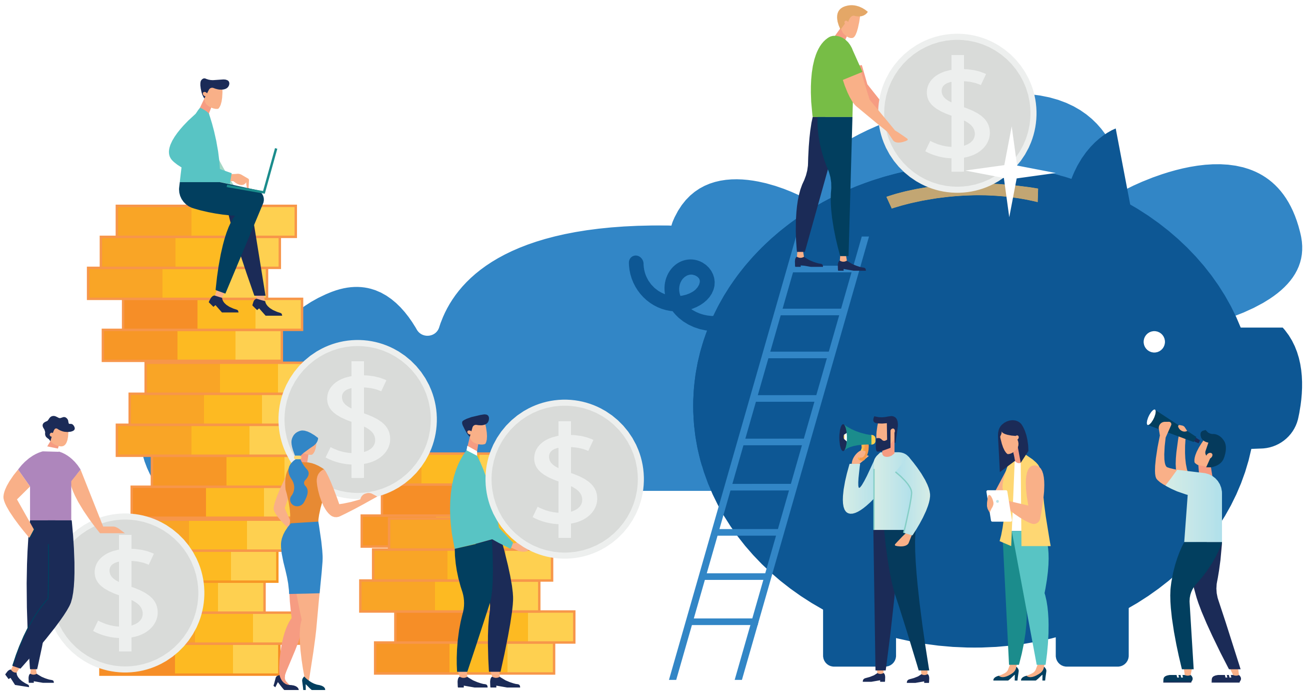
Medical expenses do not go away. In fact, they tend to grow with inflation and increased utilization over time. Often peaking in retirement, healthcare costs can slowly erode fixed household budgets. If this trend continues, HDHPs may become the dominant health benefit option across the country. While these plans have limitations and may not be the best choice for everyone, the HSA option could be the ideal strategy to help healthy Americans reduce premiums, dedicate savings to annual medical expenses, and fund retirement healthcare costs through a systematic long-term investment approach.

Also, because HDHPs tend to increase healthcare ownership, more firms may augment plans with comprehensive tools and education to help employees make the best choices for their physical and financial wellness — a combination that could result in a win/win for companies and their workers.



# Appendix

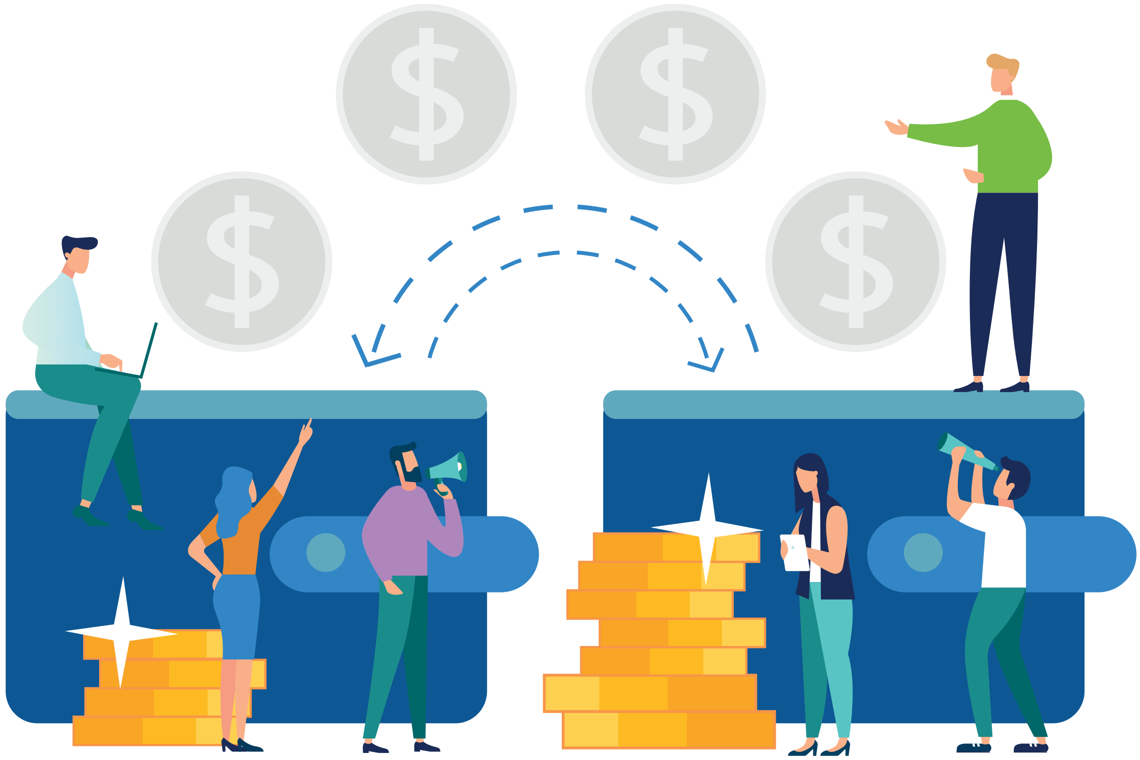
## A Brief Overview of Employer Health Insurance Options

Understanding coverage is perhaps the most important step in healthcare cost ownership. Unfortunately, most employees simply do not know enough about their plans to make informed decisions. According to PolicyGenius, only 4% of Americans could accurately define four basic terms — deductible, coinsurance, copay, and out-of-pocket maximum — relating to health insurance. That same survey reports that only 40% of Americans are "very confident" in their ability to choose the best insurance plan for their needs.[10]

Table 1 provides a snapshot of the three most common insurance options.

**Table 1: Benefit Comparison: PPO, HMO, and HDHP**

| PPO<br>Preferred Provider Organization | HMO<br>Health Maintenance Organization | HDHP<br>High Deductible Health Plan |
|---|---|---|
| Average 2019 premium contribution:<br>Single coverage: $1,454<br>Family plan: $6,638[11] | Average 2019 premium contribution:<br>Single coverage: $1,058<br>Family plan: $6,009[12] | Average 2019 premium contribution:<br>Single coverage: $990<br>Family plan: $4,376[13] |
| **Pros**<br>■ Out-of-network flexibility<br>■ Usually offer more care options (such as chiropractic)<br>■ Larger network=more choice | **Pros**<br>■ Lower premiums than PPOs<br>■ Low or no deductible<br>■ Cost effective if you have a PCP in the HMO | **Pros**<br>■ Lower premiums than HMOs and PPOs.<br>■ Triple tax benefits through HSAs<br>■ Participants take charge of their own wellness |
| **Cons**<br>■ Must file own claims for out-of-network coverage<br>■ Higher premiums<br>■ Must meet deductible before coverage begins | **Cons**<br>■ Few out-of-network options<br>■ Less flexibility<br>■ Primary care provider must approve referrals | **Cons**<br>■ Higher deductibles than PPO<br>■ Not usually cost-effective for those who ned frequent care<br>■ Caregiver options vary between plans |



PPOs are usually advantageous for individuals who frequently use medical services, utilize several care options (such as chiropractic or acupuncture), and want more out-of-network flexibility. Individuals who prefer reduced up-front costs may opt for an HMO, which has lower premiums and (often) low or no deductibles. HDHPs may attract individuals who seldom require care. These plans have the lowest premiums and offer access to HSAs, a triple-tax-free investment vehicle that can accumulate over time and be used for future healthcare needs.

Table 2 outlines the average annual premiums of all plan options.

### Table 2: National Average Annual Premium Costs for Employer-Sponsored Health Insurance, by Type*

| | Individual | | | Family | | |
|---|---|---|---|---|---|---|
| | Total Premium | Employer Portion (assumes 75% contribution) | Employee Portion (assumes 25% contribution) | Total Premium | Employer Portion (assumes 75% contribution) | Employee Portion (assumes 25% contribution) |
| **PPO** | $8,361 | $6,271 | $2,090 | $13,447 | $10,086 | $3,362 |
| **HMO** | $7,974 | $5,981 | $1,994 | $12,793 | $9,595 | $3,198 |
| **HDHP** | $7,326 | $5,495 | $1,832 | $11,501 | $8,626 | $2,875 |

**These are national averages: costs may vary from state-to-state.*

HDHPs typically have the lowest premiums because of the high deductible. PPOs, which offer added benefits like out-of-network flexibility, tend to be the most expensive for firms and their employees.

# About HealthView

Founded in 2008 by a team of financial professionals, healthcare industry executives, and physicians, HealthView Services is the nation's leading provider of healthcare cost projection software. It's portfolio of retirement healthcare planning applications – which create comprehensive and reliable cost projections for 33 million users annually – is utilized by advisors, financial institutions, employees and consumers.

Drawing on actuarial and government data, as well as 530 million medical claims, these applications rely on a patented data process that utilize simple user inputs (age, gender, health conditions, income, and location) to create personalized estimates of retirement healthcare costs. The data also incorporates inflation projections for each component of retirement healthcare: Medicare premiums, supplemental insurance, and out-of-pocket spending for dental, vision, and hearing.

With more than a decade of use across the financial services industry, these solutions have proven to be a powerful driver of savings and retirement planning. The firm has numerous software applications which include healthcare cost projections, long-term care costs, Medicare premiums and surcharges, Social Security optimization, etc. These tools give financial services' clients and retirement plan participants with an individualized and actionable savings plan aimed at funding a customized expense projection.

HealthView also offers product training, professional speaking, and custom content creation services. The firm regularly publishes white papers on several industry topics, as well as its annual retirement healthcare costs projection update.

# Footnotes

1 https://www.ssa.gov/oact/TR/TRassum.html

2 https://www.usnews.com/news/health-news/articles/2020-02-07/a-quarter-of-middle-aged-americans-worry-they-cant-afford-health-care

3 HealthView Services data

4 https://www.globenewswire.com/news-release/2019/04/30/1812637/0/en/Healthcare-costs-remain-top-concern-in-retirement-but-many-Americans-lack-a-savings-plan-Franklin-Templeton-finds.html

5 https://www.cdc.gov/nchs/products/databriefs/db317.htm

6 https://www.nber.org/digest/dec15/w21632.html

7 https://www.kff.org/report-section/ehbs-2019-section-8-high-deductible-health-plans-with-savings-option/

8 HealthView Services data

9 HealthView Services data

10 https://www.policygenius.com/health-insurance/health-insurance-literacy-survey/

11 https://www.kff.org/report-section/ehbs-2019-summary-of-findings/

12 Ibid

13 https://www.kff.org/report-section/ehbs-2019-section-8-high-deductible-health-plans-with-savings-option/#figure85