NATIONWIDE RETIREMENT INSTITUTE®

A new perspective on Health Savings Accounts

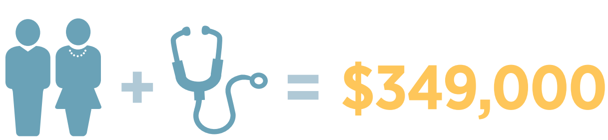
Learn how HSAs can help employees save for health care costs in retirement

Executive Summary

The benefits landscape in the United States is rapidly changing along with the value and delivery of those benefits. With millions of baby boomers approaching retirement—and millennials set to make up 50% of the world's work force by 2020[1]—which benefits are most critical and how these benefits are delivered, owned, used, transitioned and deployed are taking on new meaning. Those closer to retirement often ask if they have enough savings and question what their health care needs will be in retirement.

Younger workers are also mindful of their prospects in retirement and have placed a premium on being in the best position possible later in their career. 88% of millennials agree that it's important to start saving early for retirement. Among Gen Xers, that number actually falls to 86%. However, both groups agree that saving for retirement is a priority, with a combined average of 83%.[2]

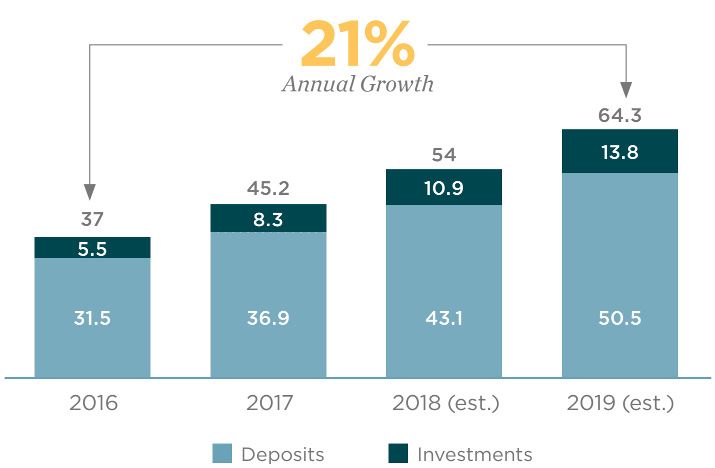
What these seemingly very different parts of our working population have in common is that both have an opportunity for greater control over one of the biggest determinants of retirement success: their financing and consumption of health care today, tomorrow and well into the future.



A couple retiring today could need $349,000 for health care costs throughout their retirement.[3]

Health care costs in retirement are high, but there are ways to save more effectively. Health Savings Accounts (HSAs) create a method for people to save on a tax-free basis for health care costs. HSAs are growing rapidly.

National HSA Assets ($B)[4]



Given these and many other factors, we can understand the focus on health care costs in retirement and the need to save and invest for those costs today. The inclusion of an HSA in addition to more traditional savings and investment vehicles could be another avenue to solidify success not only in retirement but throughout the entirety of a successful career.

How HSAs function

Despite being available to the public for over 12 years[5] (and even longer via its predecessor, the Archer Medical Savings Account) the particulars of the HSA remain elusive to many. Adoption rates of high-deductible health plans were relatively low and the overall usage of HSAs was correspondingly low, but times have changed.[6]

With the cost of care for both employers and employees rising[7], many employers are looking to accomplish several tasks. Not only are they searching for strategies to mitigate rising insurance costs, but also continue to offer desirable benefits packages in an effort to gain and retain talent.

Key features of HSAs

HSAs create tax preferences in three distinct ways, pretax contribution, tax-free growth and tax-free distributions. Let's take a look at each item:

- Pretax contribution
  - Fund with pre and post-tax employer and employee contributions
  - Lowers the current year taxes by reducing taxable income
- Tax-free growth
  - Distributions for qualified health care expenses are tax free
  - Investments held in the HSA can grow on a tax-deferred basis, much like an IRA
  - Roll over to another provider when changing jobs—can also move to another provider at any time (provided the HSA is not an ERISA plan)
- Tax-free distribution to pay for qualified medical expenses
  - Penalty-free withdrawals for any expense after age 65 (subject to ordinary income taxation)
  - Transfer to a spouse or other beneficiary upon death

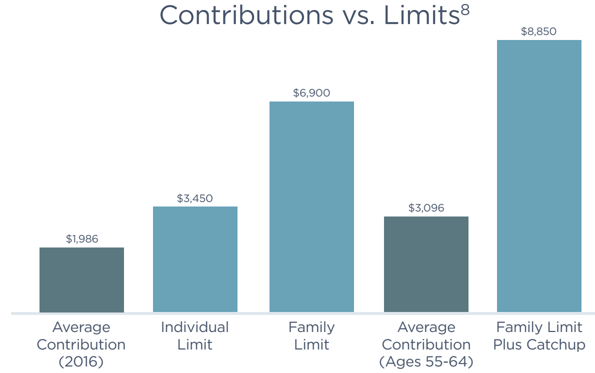
Taxation and penalties

- Withdrawals are subject to taxation plus a 20% penalty for nonqualified health care expenses
- Penalty is waived when an individual
  - Is 65 or older
  - Is disabled
  - Has died during the year

IRS contribution limits (2018)

- Individual: $3,450
- Family: $6,900
- Catch up: 55 years and older: $1,000; spousal catch up of $1,000 as well (if placed in a separate HSA under their name)
- Contributions can be made up to April 15 of the following year, provided the account was open and qualified in the previous year (similar to IRAs)

Contributions vs. Limits[8]



Who can contribute

- Must participate in a high-deductible health plan
- Minimum deductibles for their health insurance plan
  - Individual: $1,350
  - Family: $2,700

How to use it

- Qualified expenses include
  - Most health care-related expenses, as defined by IRS publication 502
  - Plus premiums for
    - Medicare Premiums for Parts B, C and D (but not Medigap policies) and other health care expenses for individuals aged 65 or older
    - Long-term care insurance
    - COBRA coverage while on unemployment
- What you can't use it for
  - Unlike a 401(k), you can't take loans against your HSA

HSAs are much more than a tax-preferred checking account for current medical expenses. While HSAs are useful for current medical expenses, their flexibility and features mean they are useful for long-term savings as well. As shown in the following scenarios, an HSA can be used to accomplish a variety of objectives. These include:

- Saving and investment vehicle for health care costs in retirement
- Funding current expenses while keeping future needs in mind
- Immediate funding of health care and insurance expenses in a tax-efficient manner

HSA Scenarios

These scenarios discuss three different situations, each with its own set of circumstances, objectives, available resources and potential outcomes. What they have in common is that each potentially uses an HSA to achieve short and long-term goals.

The three scenarios below are for illustrative purposes only. Every client is different and should consider the whole of their financial situation.

Scenario 1
Meet Greg and Jane — saving for retirement

- In their early 50's, good health and modest health care costs
- They've been saving for retirement and usually make the maximum 401(k) contribution
- Greg's employer recently switched to a high-deductible health insurance plan, which creates another savings opportunity
- They decide to contribute their annual family maximum of $6,900 to their HSA (for 2018)
  - Can grow earnings more rapidly because they aren't taxed
  - Accelerate growth by paying most minor health care costs out of pocket
  - Allow the balance to grow and use those savings to help pay for health care costs in retirement

Scenario 2
Meet Susan — young and healthy

- 32 years old, single and recently promoted
- She takes great care of herself so she has very low health care costs
- She's been contributing to her 401(k) and her HSA at work, but thought she had to use all of the HSA each year or lose those dollars
- Susan learned that she can let her HSA balance grow each year and she could roll her HSA into any new employer's plan or into her own account if she changes jobs
- Susan can use it when she has health care expenses or let it continue to grow until she retires
  - Even if she doesn't need it for health care costs, she can access the funds without the 20% penalty up until the time she reaches age 65[9]

Scenario 3
Meet Doug and Mary — planning for a family

- Both 25 years old, recently married and thinking of starting a family soon
- Currently saving enough in their 401(k) plans to get their full employer match and have an emergency fund to cover a few months of expenses
- Mary received a raise of $3,000, so they're deciding where they might save the additional income
- Likely to face significant costs when they start a family, given their family deductible is $6,000
- By starting to save the $3,000 in their HSA for two or three years, they could potentially have enough to cover their deductibles
  - Because the savings are made and spent on a pre-tax basis, they could save more this way than trying to accumulate these savings in a traditional after-tax vehicle

The impact of an HSA in conjunction with a qualifying high-deductible health plan and other savings vehicles can play a key role in how we use our health care dollars. An HSA can impact the health care financing and delivery methods for each situation and positively impact people in the immediate, short and long-term as well as at retirement and beyond.

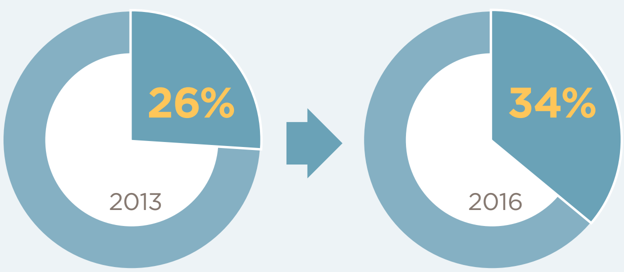
Advantages

Employers

While the HSA account holders have many advantages, they are not the only groups to benefit. Employers are seeking top talent across all skill levels and realize that a robust benefits package, most often led by strong health care benefits, can be a key factor in attracting and retaining talent.

The Society of Human Resource Management data shows that employers continue to have difficulty recruiting employees at all levels and that difficulty is on the rise. In the "dual mandate" of attracting talent and reducing costs, 22% (the majority) said that offering consumer-directed health plans is the most successful way to help control the cost of health care.[10]

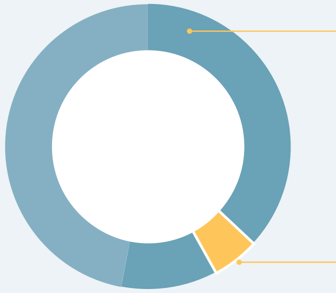
Employers answering yes to having recruiting difficulty[11]



Another consequence of an employer offering the high-deductible health plan/HSA combination is its potential to:

- Improve retirement outcomes
  - HSA can be a more tax-efficient way to save for retirement health care costs because of the triple tax benefit
- Potentially save the employer in health care insurance expenses
  - May allow earlier retirement if assets are available to help cover expenses prior to Medicare eligibility
  - May help lower the cost of providing health insurance when a high-deductible health insurance plan is the best option for an employer
  - May free up company assets for other benefits or human resources expenses

Advisors



53% of older adults who have talked about retirement to a financial advisor say that discussing health care costs is important. *However, only* **10% have had that discussion.**[11]

Health care is often the largest and most misunderstood aspect of retirement income planning. The idea that a "health" account of any kind would be a talking point for a private wealth or corporate retirement advisor may have been foreign in years past, but an HSA is not your average saving and investing vehicle.

Expand your expertise

- The inclusion of HSAs to an advisor's practice is a timely differentiator that demonstrates broad retirement expertise and investment acumen
- By articulating the investment opportunities in many HSAs, advisors can increase their value in the benefit broker and CPA referral network
- HSAs have many advanced planning implications surrounding efficient accumulation and distribution strategies, legacy planning, long-term care financing and taxation

Contact the Retirement Institute Income Planning Team at 1-877-245-0763 to learn how HSAs can help employees save for retirement.

[1] http://www.pwc.com/us/en/people-management/publications/nextgen-global-generational-study.html.

[2] http://www.benefitspro.com/2016/01/27/5-retirement-savings-myths-about-gen-x-and-millenn?slreturn=1455714220&page=3.

[3] "Savings Medicare Beneficiaries Need for Health Expenses: Some Couples Could Need as Much as $350,000" at age 65 in 2016, assuming 90% chance of having enough savings, EBRI, January 31, 2017."

[4] Devenir Research 2018 Midyear HSA Market Statistics & Trends. 2018.

[5] The Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

[6] Devenir Research 2017 Year-end HSA Market Statistics & Trends. 2017.

[7] 2015 Medical Trends and Observations Report. Corporate Executive Board.

[8] Health Savings Account Balances, Contributions, Distributions, and Other Vital Statistics, 2016: Estimates from the EBRI HSA Database. 2017.

[9] There is a 20% penalty if the HSA assets aren't used for health care expenses prior to age 65. IRS Publication 969, 2015.

[10] SHRM Survey Findings: 2016 Strategic Benefits - Leveraging Benefits to Retain and Recruit Employees (Nov. 2016).

[11] https://www.nationwide.com/health-care-survey-results.jsp.

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