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HSA: An Overlooked Retirement Benefit

by BARBARA DELANEY

In 2003, health savings accounts (HSA) were created as part of the Medicare Prescription Drug, Improvement, and Modernization Act. This act provides a tax-free program for the funding of medical expenses that are not covered by health insurance. An HSA is a savings account in which the funds are exclusively used to pay for qualified medical expenses. Over time the funds grow, with no time limit on when they must be used. In contrast, with a flexible spending account, the funds must be used or lost at the end of each 12 month period. Theoretically, the funds could accumulate for decades and be used during retirement when medical expenses tend to soar.

Since 2003, HSAs have steadily become part of the mainstream in two distinct ways. As an employer, an HSA can be a health insurance benefit in combination with offering employees a high deductible health insurance plan (HDHP). Individuals and/or families can also purchase high deductible insurance plans to save on medical insurance premiums. They can then open their own HSA account. In fact, within the next year or two, a majority of large companies, as well as many small businesses, are likely to offer an HSA. Unlike traditional health insurance plans, HSAs require full funding

of medical expenses by the insured via the HDHP until the deductible is met. Once that limit is met, the HDHP usu-

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ally covers 100% of eligible medical expenses. Deductibles can range from \$2,600 to \$13,100 for a family and \$1,300 to \$6,550 for an individual (single). At first glance, that level of out-of-pocket seems pretty scary to the average person versus paying a small co-pay, but there is so much more to HSAs.

Before we share the retirement benefits of an HSA, let's quickly explore how they operate. Employees contribute to the health savings account; that contribution is tax exempt up to an annual predefined limit. The current tax-free employee contribution limit is \$6,750 for a family and \$3,400 for an individual, plus an additional \$1,000 for employees over 55 to help them catch up. Moreover, many employers contribute to each employee's account. The average annual employer contribution is approximately \$900 for a family or \$500 for an individual. However, some companies contribute as much as \$2,000 to their employee's account.

Once an HSA is established, like a 401k, the account remains with the employee regardless of job changes. Employees and employers also enjoy the immediate benefit of significantly lower monthly premiums. Another instantaneous financial advantage is that most HDHPs cover preventative care at 100%, no copay is required; due to this, more people are receiving preventative care than those using traditional insurance.

At this point, everything we've covered is fairly common knowledge regarding the health coverage HSAs provide. But a really important benefit of an HSA, which often goes unnoticed, is the retirement benefit. Yes, HSAs

offer a tremendous retirement benefit; now let's examine why. Traditional health insurance premiums can be expensive. By offering an HHDHP, premiums are decreased – often drastically. This allows employees to divert the money they are saving on the lower premium into their HSA (and businesses can redirect their portion of the premium savings to other areas that may be in need of funding). The funds' employees contribute to their HSA are exempt from taxes up to the limit established by the Internal Revenue Service (IRS). Investment gains made from the HSA are also tax-free. If you are lucky enough to live in a state that follows the IRS guidelines, additional savings are made against state income tax liability. All of this is a great opportunity to save and build funds, but there is still more. Because most HDHPs will pay 100% for preventative care, money is saved on copayments for things like immunizations, screenings, and routine physical exams, which provide another source for HSA contributions. Finally, many employers will contribute to money their employee's account, that contribution is tax-free for both entities.

Our example family of four doesn't have any serious health issues, but has a baby and young child. Immunizations and routine physicals are covered at 100%. In theory, they would have zero out-of-pocket medical expenses over the course of a year. There will be enough in the HSA to cover the maximum family deductible in two years. Five years after establishment, the HSA is worth over \$30,000 and in 10 years over \$62,000. After 30 years, when it's time to retire, the account

could have grown to \$185,000+.

Unfortunately, Medicare, as it stands today, leaves many financial gaps that must be absorbed by the patient, which can be challenging if living on a fixed income. Adding more potential stress is the trend of rapidly rising medical costs for senior citizens. With the financial backing of an HSA, the high cost of health care for the elderly is dramatically mitigated. This allows those seniors to use their other

welfare benefits consultants on health insurance options, thus aren't always presented with the entire picture. The retirement benefit isn't discussed because health insurance consultants typically aren't experts on the investment side and are not licensed to discuss them, so the conversation never is brought up. Since C-level executives don't think of HSAs as an investment, they are not using as much investment strategy, unlike pension plans or 401ks.

Lastly, but of equal importance, is the introduction to employees. When employees are introduced to an HSA, the focus is often solely on the health insurance portion. This means that the average employee has no idea about the retirement benefit, thus is less likely to actively participate in growing the account. However, as HSAs continue to make their way into mainstream health insurance offerings, and more educational materials are created, there is no doubt, the retirement benefits will no longer be overlooked. ★

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FAMILY OF FOUR WITH AN ANNUAL INCOME OF \$120,000

- \$1,200 – annual savings on lower premium
- \$300 – savings on preventative care
- \$1,687 – savings on federal income tax
- \$500 – FICA
- \$2,000 – employer contribution
- \$558 – gain on investment – 10%
- \$6,245 – saved and/or made in one year

retirement income for living expenses and life enrichment experiences, such as travel or lavishly spending on grandchildren. Based on this data, there is no doubt that an HSA can be a bonanza for retirees.

Once the data is crunched, it's fair to wonder why such an outstanding retirement benefit is so often ignored. There are a few probable reasons. To begin with, even though HSAs are over a decade old they've just recently begun to become inclusive of mainstream employer-based health insurance offerings. Benefit professionals and human resource executives tend to work with health and

HSA

