KS ADVISOR BLOG

HSAs Largely Untapped for Retirement Savings

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Health care is a major cost in retirement, yet many people don't plan effectively for it. Fidelity's annual Retiree Health Care Cost Estimate showed that in 2022, an average retired couple age 65 needs $315,000 (after tax) to pay for expenses, nearly a 5 percent increase from 2021. Many Americans may not be prepared for these costs, given that the average 401(k) account balance for 65-year-olds is just under $280,000, according to Vanguard's How America Saves report.

Health savings accounts (HSAs) are a powerful retirement planning tool to help solve this problem. Plan sponsors who offer high deductible health plans (HDHPs) can help plan participants prepare for health care spending in retirement by offering HSAs.

In this two-part series, we highlight growth in HSAs, some misconceptions about them, and the critical need for thoughtful education and communications. Our second article will cover best practices when selecting an HSA provider.

HSAs Grow as Health Care Piggy Banks

HSAs have continued to grow when measured by the number of accounts and level of assets. Devenir's 2022 year-end report on HSAs showed the 35.5 million accounts held $104 billion in assets, a year-over-year increase of 9 percent for accounts and 6 percent for assets. Most HSA participants use their accounts to pay for medical expenses rather than as a retirement saving tool: Participants contributed $47 billion to their accounts in 2022 and withdrew nearly three quarters of that amount for health care expenses.

Results from the Plan Sponsor Council of America's fourth annual HSA benchmarking report shows that employers commonly use automatic enrollment — as they often do with 401(k) plans — to boost usage of HSAs as retirement savings vehicles. More than 40 percent of respondents to the PSCA survey automatically enrolled employees into their company's HSA in 2021, a 6% increase from the previous year. More than three-quarters of employers contribute to participants' accounts, and 61 percent offer HSA investment options. While the majority of the investment choices are determined by the HSA provider (93 percent), more than one fifth of participants took advantage of these strategies.

Education is a major concern for 70 percent of employers. While many employers (65.5 percent) focus education efforts on HSA tax benefits, 34.5 percent help participants understand how saving in an HSA can help during retirement.

Common Misconceptions with HSAs

Acronyms plague the health care space, so it is easy to confuse the various spending accounts associated with health plans and their rules, contribution limits, and other facets. Here are details on the three health-focused accounts and their features:

- Health savings account (HSA)
  - Employee must have a HDHP

  - Money goes in tax-free, grows tax-free, and can be withdrawn tax-free if used for medical purposes
  - Employee owns the account (assets are portable)
  - Employee can invest monies in the account (if the plan document allows)
  - Contributions are tax-deductible for employers
  - Internal Revenue Service (IRS) 2023 contribution limit: $3,850 for individuals and $7,750 for families
- Health Reimbursement Account (HRA)
  - No HDHP needed
  - Employer owns and funds the account
  - Funds are not invested and account is not portable
  - No tax implications for employee, but contributions are tax-deductible for employers
  - No annual contribution limits
- Flexible Spending Account (FSA)
  - No HDHP needed
  - Employer owns the account, but employees can contribute to it
  - Funds are not invested and account is not portable
  - Contributions are tax-deductible for employers and employees
  - Unused portion is forfeited at the end of the year (“use it or lose it” rule)
  - 2023 contribution limit: $3,050

It is important to note that employees can open their own HSA if their health plan clears the IRS minimum deductible qualification of $1,500 for individuals and $3,000 for families. In addition, account holders age 65 and up can use HSA dollars for any kind of expense but must pay taxes on withdrawals, similar to a traditional 401(k).

Education Can’t Be Stressed Enough

While HDHP employees tend to be savvier with their health care choices, most employees spend very little time selecting a health plan during open enrollment, as highlighted in a recent survey from the Employee Benefit Research Institute (EBRI). Nearly a quarter of respondents to the EBRI survey were automatically re-enrolled in their previous year’s choice.

It can be challenging to find time to educate employees, especially during open enrollment period. Interestingly, 20 percent of respondents to the PSCA’s recent survey said they educate employees about

HSAs throughout the year. While tax benefits remain the main focus of HSA education, there is a major opportunity for employers to focus education on the value HSAs can provide for long-term financial planning and retirement savings.