AN EMERGING RETIREMENT PLANNING STRATEGY

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Health Savings Accounts: An Emerging Retirement Planning Strategy

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Summary

Health Savings Accounts (HSAs), held by about 7 percent of Americans,[1] are most often used as a tax-preferenced bank account to cover current medical expenses. However, a growing segment of HSA account holders are recognizing the potential of leveraging them as part of a retirement planning strategy. To measure current use of and attitudes toward HSAs, the LIMRA Secure Retirement Institute partnered with the Insured Retirement Institute (IRI) to poll consumers, advisors, asset managers, and employers on their familiarity with HSAs, their use of these accounts as part of a holistic retirement planning strategy, and their outlook on the future. While less common, use of HSAs in longer-term retirement planning strategies seems to be gaining traction — especially among advisors and younger, affluent consumers.

BACKGROUND

The HSA, established as part of the Medicare Prescription Drug, Improvement, and Modernization Act, became law in January 2004. An HSA is a tax-advantaged account created to help individuals who are covered under high-deductible health plans (HDHPs) save for medical expenses that these plans do not cover. Contributions are made to the account by the individual and/or the individual's employer and are limited to a maximum amount each year, currently $3,450 for individuals and $6,900 for families. Annual catch-up contributions of an additional $1,000 are available to those over 55 years of age.

Contributions are invested over time and can be used to pay for qualified medical expenses, which include most medical care as well as dental, vision, and over-the-counter drugs.

Developed to replace the medical savings account (MSA) system, HSAs have driven expanded access to consumer-driven health plans. While MSAs were limited to the self-employed or employers with fewer than 50 employees, HSAs are available to anyone enrolled in a HDHP. In combination with the assumption of greater personal responsibility for a larger portion of healthcare expenses inherent in HDHPs, HSAs give individuals a tax-preferenced, personally owned savings account earmarked to pay healthcare costs if/when they occur. As an incentive for individuals to participate, and/or to ease the transition to an HDHP, many employers make voluntary contributions to these accounts.

So, much as the advent of defined contribution plans circa 1980 ushered in a long, steady shifting of responsibility for retirement savings from employers to workers, growing use of HDHPs with HSA accounts is triggering a similar shift toward individual responsibility for healthcare decisions and costs.

Hailed by its advocates for its triple tax benefit — money goes in tax-free, accumulates tax-free and is spent tax free — challengers worry users may skimp on healthcare and let initially small problems become big ones as a result.

AVAILABILITY

Estimated incidence of access to and participation in HSAs across worker populations vary depending on how each poll defines the universe. Annually, United Benefits Advisors (UBA) conducts one of the largest plan sponsor surveys to measure access and participation. In their 2016 Health Plan Survey, they estimated HDHP availability at 25 percent of the 20,0000 health plans surveyed, reflecting a 22 percent increase from five years prior. They further estimated HSA enrollment at 17 percent of eligible employees, reflecting a 26 percent increase from 2015, and a 140 percent increase from five years earlier.[2]

However, despite this strong growth in the incidence of accounts, account balances remain low.

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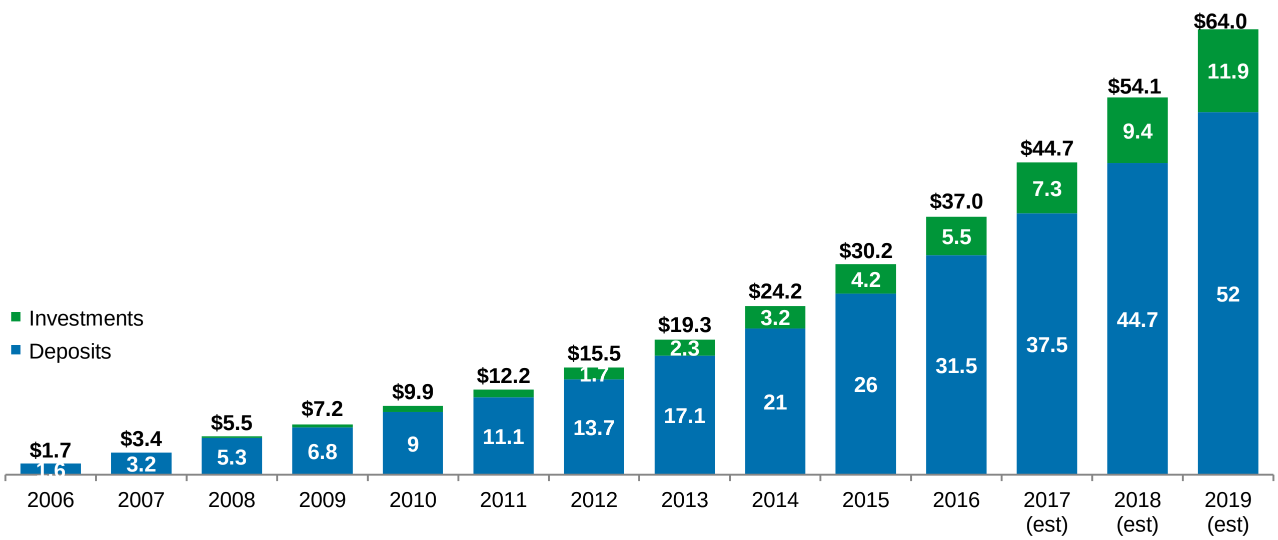
[1] 2017 Health Plan Survey, United Benefit Advisors.

[2] 2017 Plan Design and Cost Benchmarking Key Results, United Benefit Advisors.

Devenir Research has been measuring asset growth since HSAs were first introduced. An increase from just $1.6B when first measured in 2006 to $37B as of year-end 2016 reflects increasing momentum. Over the next three years, Devenir Research projects an annual growth rate of 20 percent, bringing industry-wide HSA account assets to $64 billion by 2019 (Figure 1).

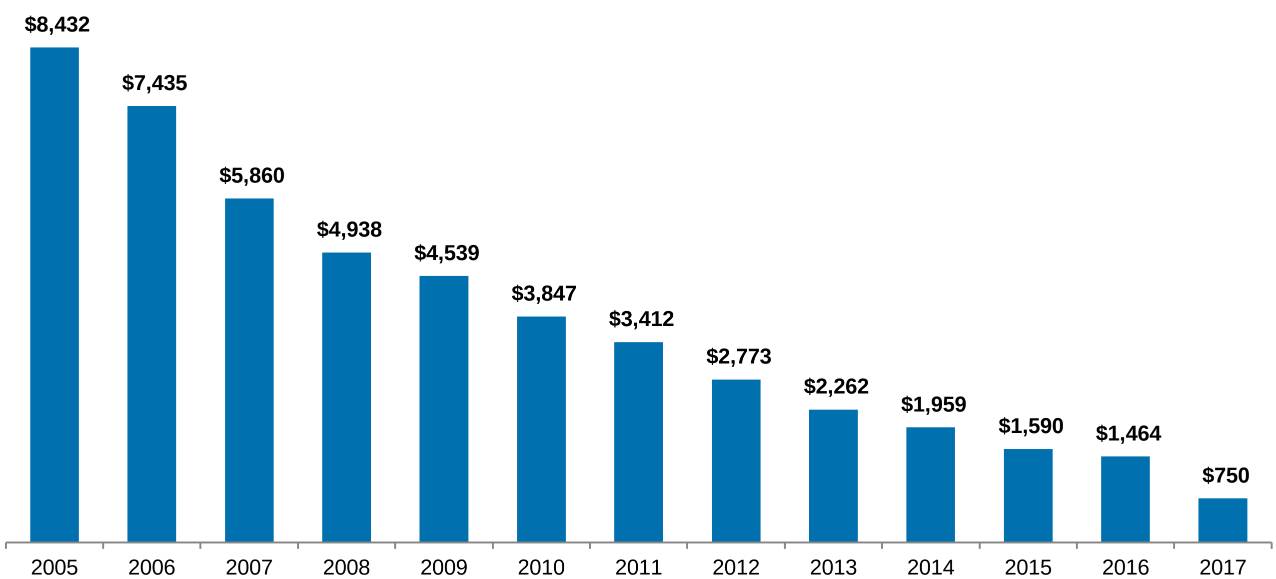
Figure 1 — Total HSA Assets

(in billions)



Source: 2017 Midyear HSA Market Statistics & Trends, Devenir Research

Figure 2 — Average Balance by Year the HSA Opened

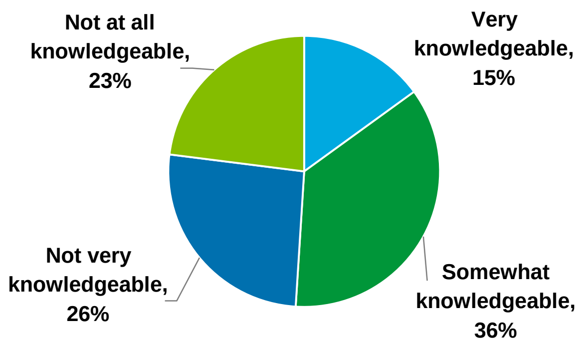


Source: 2017 Midyear HSA Market Statistics & Trends, Devenir Research

The Consumer View

One in two consumers describe themselves as at least somewhat knowledgeable about HSAs; the other half say they are either not very or not at all knowledgeable (Figure 3).

Figure 3 — How knowledgeable are you about the features and benefits of health savings accounts (HSAs)?

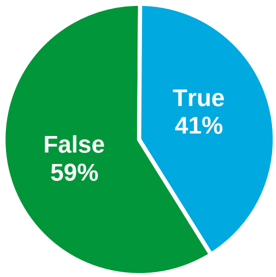


Based on 1,328 non-retired workers.

Reflecting the findings of recent, similar research, many Americans confuse HSAs with Flexible Savings Accounts (FSAs) and often think of them as a "use it or lose it" proposition.

Among those who report being at least somewhat knowledgeable with HSAs, 2 in 5 mistakenly believe that balances must be spent by the end of the year or forfeited (Figure 4).

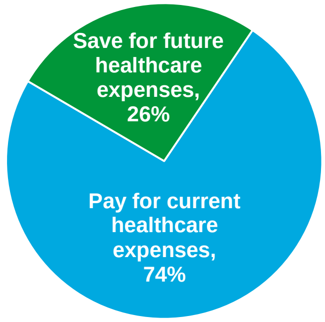
Figure 4 —You are required to spend your entire health savings account (HSA) balance by the end of the year or risk forfeiting the balance.



Based on 1,149 workers who are not somewhat or very knowledgeable with the features and benefits of HSAs.

Even among those who are aware an unused HSA balance can roll forward from year-to-year, the tendency is to use HSAs primarily to pay current-year health costs. For now, preserving an HSA account balance as an opportunity for tax-free growth and as a financial hedge against retirement healthcare costs is still an uncommon strategy (Figure 5).

Figure 5 — Do you primarily use your HSA to …?



Based on 294 non-retired workers participating in an HSA.

Still, current retirees who tell us they are spending more money in retirement than they had expected most often cite unexpected healthcare costs as the culprit.

Not surprisingly, today younger and more affluent Americans are the most likely to choose the HDHP/HSA strategy.[3] It makes sense, as they have the lowest current out-of-pocket medical expenses, the most capacity to pay those expenses out of current cash flow, and the most time for their accounts to benefit from tax-free growth.

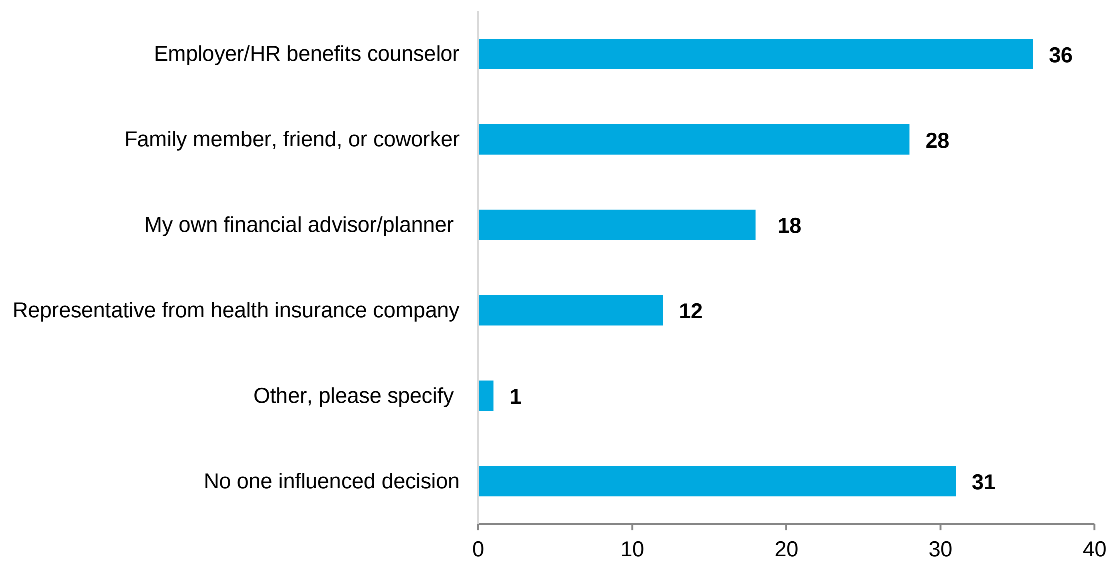
[3] EBRI Issue Brief No. 438, September 19, 2017, Employee Benefit Research Institute.

For retirement plan providers and sponsors concerned that offering HSAs may cannibalize their defined contribution plan balances, the research does not bear that out. Savers in HSAs also save more in their DC plans. Fidelity reports that people saving in HSAs do not do so at the expense of a DC retirement plan, such as a 401(k). During 2016, Fidelity found that customers with both DC and HSA accounts saved on average 10.7 percent of their annual income in the retirement account. Those with only a DC account saved, on average, 8.2 percent in that account.[4]

OTHER CONSUMER FINDINGS

- Wealthier households are more likely to be knowledgeable about HSAs. Among households with $100,000 or more in financial assets, 65 percent are knowledgeable as compared to just 40 percent of those with less wealth.
- Men are more likely than women to report being knowledgeable about HSAs (58 percent of men versus 48 percent of women are somewhat or very familiar).
- By a margin of 69 percent to 52 percent, married workers report more HSA knowledge than do non-married workers.
- Confirming the strong role employers play in driving awareness of HSAs, knowledge is higher among workers than consumers who are not working. Two-thirds of full-time workers, 53 percent of part-time workers, 38 percent of retired consumers, and 28 percent of non-retired consumers not working for pay are somewhat or very knowledgeable with HSAs.
- Consumers with children report more HSA knowledge than those without children (55 percent versus 44 percent).
- Employers are most influential in decision to open an HSA account (Figure 6).

Figure 6 — When you initially enrolled in your health savings account (HSA), did any of the following people influence your decision to do so?



Based on 691 consumers who currently own a health savings account.

[4] Fidelity Retirement Savings Analysis: Savings Rates, Account Balances Climb to Record Levels in First Quarter, Fidelity Investments

The Advisor View

The vast majority of surveyed advisors (9 in 10) report that they typically discuss healthcare or long-term care with clients, and 7 in 10 have specifically addressed the use of an HSA. Advisors who do not discuss HSAs most often site insufficient expertise with HSAs as the reason, with many among that minority expressing interest in learning more. Nearly all advisors (96 percent) — regardless of their self-assessed knowledge of HSA strategies — say they would like to learn more.

> *"... HSAs are becoming more and more important. We try to tell them that in the Medigap phase and the Medicare phase, they're going to be spending about $263,000 out-of-pocket. They need to prepare for that ..."*
>
> **— Advisor Focus Group Participant**

While most HSA accounts are used to pay current healthcare expenses, the dominant advice given by advisors regarding the optimal use of an HSA is to reserve for unplanned, non-routine expenses or to save to cover medical costs in retirement. While most advisors (68 percent) suggest this to their clients, among those with a personal HSA account a good number use them to cover current costs (31 percent) rather than save for medical expenses in retirement (24 percent). Others hold for non-routine expenses whenever they occur. Using HSAs for non-routine and/or retirement medical expenses is higher among advisors than among Americans at-large, but still less often than they recommend to their clients. As with so many things, deferred gratification is more easily achieved in an intellectual exercise than in practice.

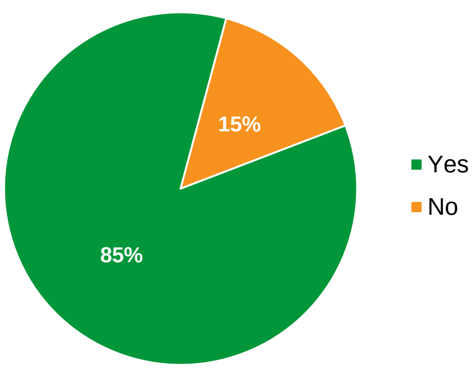
> *"... I think that, going forward, that is one area that we may see greater growth. And, ultimately, I would like to see it on a more individual basis, where individuals get to choose where to have their HSA, how it should be invested, and have control over that decision..."*
>
> **— Advisor Focus Group Participant**

The Employer View

LIMRA's survey of 1,497 private employers with 10 or more employees reveals growing interest in both HDHPs and employer participation in accompanying HDHPs with HSA accounts. As might be expected, the larger the employer the greater the interest.

- Most employers (85 percent) that offer a HDHP also offer an HSA.
- Among employers that currently offer a medical plan but do not offer an HDHP, 30 percent plan to offer an HDHP in the next two years.
- Among employers with an HDHP but without an HSA, only 8 percent plan to add an HSA in the next two years.
- Few employers (4 percent) plan to switch to an HDHP exclusive model in the next year and a half.

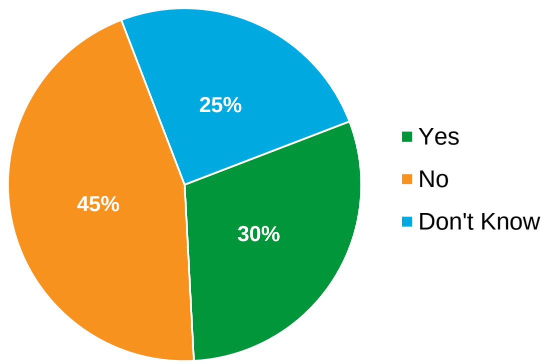
Figure 7 — Percent of Employers Offering a Health Savings Account (HSA) Linked to the High Deductible Health Plan (HDHP)



Based on 1,497 private employers with 10 or more employees in business 3+ years.

However, more employers are looking to add an HDHP in the future giving more workers access to an HDHP. In fact, LIMRA found that among employers who do not offer an HDHP, 3 in 10 expect to over the next couple of years; another 25 percent say they aren't sure. Less than half (45 percent) say they have no plans to offer an HDHP.

Figure 8 — Employers Planning to Offer a HDHP/ Consumer-Driven Health Plans (With or Without a Savings Account) in the Next Two Years



Based on 969 employers offering medical insurance that currently do not offer a HDHP/consumer-driven health plan.

Outlook

Fueled by an overall trend toward greater individual responsibility and the need for employers to contain growing medical expense costs, HSA use will continue to grow.

It is less certain whether the industry will see a meaningful shift from a bank account structure toward an investment account category, which would be necessary to gain the attention of more asset management firms.

While appreciation for the long-term tax advantages HSAs can provide (primarily to those who can afford to manage current medical expenses and defer HSA use until retirement) is low, the message is getting out. As the current administration looks for alternatives to the Affordable Care Act, proposals to expand access to — and contribution limits of — HSAs have been strongly advocated.

When the Affordable Care Act was initially proposed, the Republican counter plan, the Empowering Patients First Act, included expansion of the Health Savings Account by raising contribution limits to match IRA limits and broadening access to Medicare recipients. The Republican doctrine favoring individual responsibility favors growth in both HDHPs and HSAs.

Those asset managers betting on this growth have been actively pursuing HSA business. Others remain less convinced that account holders will let balances grow as investments rather than continue their use as a short-term bank account.

Methodology

In 2017, the following were surveyed:

- A nationally representative sample of 2,141 Americans (April)
- 132 active financial advisors;[5] (October)
- 1,497 private employers with 10 or more employees (September)

Additionally,

- Conducted two focus groups in which we probed another 20 financial advisors (September)
- Held a round table discussion on employer benefit trends with 14 plan providers and four asset management firm executives (September)

[5] The advisor survey was sent via email to advisors from the Insured Retirement Institute, because of this, the responses leaned toward advisors whose practice includes insurance solutions rather than investment-only advisors.

The LIMRA Secure Retirement Institute® was established in 2013 with the goal of providing comprehensive, objective research and education to help improve retirement outcomes. Our research agenda covers all aspects of the industry and examines issues related to saving, investing, and generating retirement income.

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