The ‘S’ Stands for Savings

Awareness of HSAs as a long-term savings and investment vehicle remains low.

BY JUDY WARD
A lack of understanding

Estimates of HSA money invested vary, but agree on relatively low current usage. Just 6.4% of HSA owners utilized the investment-option portion of the account in 2014, according to an Employee Benefit Research Institute (EBRI) analysis of its HSA database published in August 2015. (The database at that point encompassed 2.9 million accounts and $3 billion in assets.)

EBRI’s analysis found that current HSA investors have considerably higher average end-of-year account balances than non-investors: $10,261, versus $1,709 for non-investors. Their age averages 48.5, versus 43 for non-investors. The investors tend to be early adopters: 47% opened their account between 2005 and 2008, versus 8% of non-investors. The investors also contribute more annually on average to their accounts: $2,636, compared with $1,224 for non-investors.

Devenir pegs HSA investment assets at approximately $4.2 billion at year-end 2015, up 33% from a year earlier. “We estimate that at year-end 2015, about 14% of HSA assets were in investments,” Remjeske says. The percentage of HSA assets invested is growing at about one-half a percentage point annually, he adds.

The low utilization of HSA investments has roots at both the employer and employee levels. HSA investment options generally do not get discussed when employers select high-deductible health plans, Delaney thinks. “Employers are talking about HSAs with health and welfare benefit consultants, who cannot talk about investments because they are not licensed to do it,” she says. “Another reason is that many people are not licensed to do it,” she says. “Another reason is that many people are not necessarily aware that the investment option exists,” he says. “Another reason is that many people do not have large enough account balances to invest. HSA providers typically have a minimum-balance requirement to invest.”

That is a behavioral impediment, observes Jake Spiegel, senior research analyst at HelloWallet and author of its recent study, “Health Savers: The Consumer Finances of Health Savings Accounts.” People usually have to build up a sufficient balance — often $1,000 — before they have the option to invest, he says. “Not everybody is going to go back and change their investment election once they cross that threshold,” he says.

Many HSA holders also think they...
must spend the money during the current year, Remjeske says. “Unfortunately, a lot of people do not understand the carry-forward component of it. They think of it as being like an FSA, which is a ‘use it or lose it’ account,” he says. “Education has to occur for people to understand that they can carry the balance forward.”

And, in reality, most people who put money into an HSA do need to use it for subsequent medical expenses rather than long-term investing. “The majority of people just use them as spending accounts. That speaks to how not too many people have enough emergency savings to pay for a significant medical event,” Spiegel says. “To invest the money and get the maximum benefit over the long term, you really need to have sufficient emergency savings, so if something comes up with health-care expenses, you do not need to withdraw money from your HSA to pay for it.”

A Complete Retirement Advisor

After getting questions from employer clients, StoneStreet Advisor Group has started taking a closer look at the investment options offered by their HSA providers — and found lots of room for improvement.

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A recent report estimates that health care for a 65-year-old couple retiring this year will cost 6% more than a year ago — the highest estimate since 2002.

According to Fidelity’s Retiree Health Care Cost Estimate, a 65-year-old couple retiring in 2016 will need an estimated $260,000 to cover health care costs in retirement, a 6% increase over last year’s estimate of $245,000 — and the highest estimate since calculations began in 2002.

The 6% increase in this year’s estimate was attributed to several factors, including an uptick in the utilization of medical services and rapidly rising drug costs.

The estimated applies to retirees with traditional Medicare insurance coverage and provides a general idea of the monthly expenses associated with Medicare premiums, Medicare co-payments and deductibles, and prescription drug out-of-pocket expenses.

What Are the Odds?

The nonpartisan Employee Benefit Research Institute (EBRI) has previously estimated that a 65-year-old man needs $68,000 in savings and a 65-year-old woman needs $89,000 if each has a goal of having a 50% chance of having enough money saved to cover health care expenses in retirement. If either instead wants a 90% chance of having enough savings, $124,000 is needed for a man and $140,000 is needed for a woman, though that analysis did not factor in the savings needed to cover long-term care expenses.

For a married couple both with drug expenses at the 90th percentile throughout retirement who want a 90% chance of having enough money saved for health care expenses in retirement by age 65, EBRI noted that targeted savings increased from $326,000 in 2014 to $392,000 in 2015.

For Fidelity’s analysis, the estimate based on a hypothetical couple retiring in 2016, 65 years old, with average life expectancies of 85 for a male and 87 for a female. They are calculated for “average” retirees, but, as Fidelity notes, may be more or less depending on actual health status, area of residence, and longevity. Estimate is net of taxes. The Fidelity Retiree Health Care Costs Estimate assumes individuals do not have employer-provided retiree health care coverage, but do qualify for the federal government’s insurance program, Original Medicare. That calculation takes into account cost-sharing provisions (such as deductibles and coinsurance) associated with Medicare Part A and Part B (inpatient and outpatient medical insurance). It also considers Medicare Part D (prescription drug coverage) premiums and out-of-pocket costs, as well as certain services excluded by Original Medicare. The estimate does not include other health-related expenses, such as over-the-counter medications, most dental services and long-term care.

Long-Term Cares?

While Medicare covers many health-related expenses in retirement, long-term care costs are only covered by Medicare in limited circumstances. Fidelity estimates that a 65-year-old couple would need $130,000, in addition to savings for retiree medical expenses, to insure against long-term care expenses. This assumes the couple is in a good health and purchases a policy with $8,000 monthly maximum benefit, with three years of benefits, and an inflation adjuster of 3% per year.

The report notes that long-term care expenses are based on many factors, and the need for long-term care insurance (and level of coverage) is highly dependent on individual circumstances.

— Nevin E. Adams, JD
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Employees may feel motivated to look more closely when they realize that the new DOL fiduciary rules apply to HSA investments, at least on the individual account holder level, and perhaps on the employer level. “On the individual-advice side it will fall under the new fiduciary rules,” Clarkin says. “There are a lot of questions on the employer side about what it means. Everyone is still trying to understand the impact. But we are saying to employers selecting an HSA provider, ‘You need a process-driven approach.’”

The heightened fiduciary issue “is a game-changer,” Delaney says. “I think we will start to see better due diligence on HSA investments.” For employers today, that due diligence “is not even a thought,” she says. “Their health and welfare consultants do not even talk with them about the investments, because they cannot.”

Between the typically modest account sizes and limited investment choices in many cases, specialist plan advisors may hesitate to get involved for now. “The average balances are still pretty low, so I do not think you will find broker/dealers or a lot of plan advisors who have gotten really engaged about the ability to consult on HSA investments,” Metzger says. “That probably will not happen until the market matures and balances grow, and there are better investment offerings.”

Still, Metzger sees emerging advisor interest. “What we are seeing now is that the leading edge of the best plan advisors, with the big shops, have started looking at this issue,” he says. “A few are exploring doing their own HSA investment offering, or partnering with an HSA provider to white-label their investment platform.”

Clarkin thinks plan advisor interest in working on HSA investments has been a slow build, but he sees that pace accelerating. “In many cases, because of the (relatively low) balances, advisors might decide to charge a flat consulting fee and say to employers, ‘Hey, I will help you have a more-robust investment menu for your HSA,’” he says. “There is an opportunity for advisors to increase their revenue through current clients. But there is also an opportunity to be more than just the advisor on the DC plan side: You are able to come in and be the complete retirement specialist. Health care is such a big part of expenditures in retirement, and if you want to be a complete retirement advisor, you need to address that.”

Among HSA holders, much of the interest in investing likely will come from affluent employees who want to max out on their retirement-savings opportunities. “It is going to be the highly compensated,” Delaney says. “But as we get better education materials, there are going to be other people, like couples who say, ‘Let’s save my HSA money and use yours to pay medical expenses.’”

For HSA investment usage to grow, account holders need to see their HSA as important to their long-term retirement savings. “If you take a big step back, people need to look at the true cost of health care in their retirement years,” Metzger says. “There is a widely used number in the industry from Fidelity, that the average married couple will spend $245,000 in retirement for health-care costs out of their own pockets (see sidebar on page 40). Nationwide has developed a tool that, based on an individual client’s situation, can generate a personalized health care cost estimate for their retirement plan. We have seen that many of those estimates exceed $245,000.”

Because of the unique triple-tax-free nature of an HSA — the money goes in tax-free, accumulates tax free, and gets withdrawn tax-free if used for qualifying medical expenses — it works as a way to pay retiree health care expenses. “When people reach retirement and need to take that $245,000 out of their accounts to pay for health care expenses, $245,000 out of an HSA is $245,000, because the money comes out tax-free,” he says. “But if you need $245,000 out of your 401(k) account, that is something like $325,000, after you pay the marginal tax rate on that money.”

Many people do not realize how large health care expenses loom during their retirement. Metzger says. “In retirement, either the largest or second-largest monthly expense for most people is going to be health care. If it is number two, it is behind only housing costs, and most people do not understand that,” he says. “Many do not realize that the $245,000 cost estimate is made up of Medicare premiums, optional supplemental Medicare insurance, and co-pays and deductibles when they use Medicare. So when you save for retirement, whether you know it or not, you are saving for health-care expenses.”

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