10 Myths that May Impede the Retirement Planning Benefits of Health Savings Accounts (HSAs)

Happy platinum anniversary to the Health Savings Account (HSA)—celebrating 20 years as a tax-advantaged savings account covering certain healthcare costs for its owners enrolled in qualifying High Deductible Health Plans (HDHPs). The prevalence of HSAs among consumers has surged in recent years, with approximately 36 million HSAs reported in 2023. These accounts collectively hold over $116 billion in assets, representing an increase of more than 500 percent since 2013.[1] It is projected that the HSA market will exceed 44 million accounts by the end of 2026, holding $168 billion in assets.[2] Most HSA assets sit in cash accounts for immediate spending due to the misconception that HSAs are "spending" accounts and not "savings" accounts. But other than life insurance contracts and certain collectibles, the IRS does not limit the types of investments that can be offered for HSAs. In fact, several misunderstandings, or "myths" as to how HSAs can be utilized have plagued the account since the get-go. It's time to debunk some of these myths and reposition the HSA as a helpful, tax-advantaged investment account for retirement that it could be.

1. Consumer Financial Protection Bureau, Issue Spotlight: Health Savings Accounts, May 2024
2. Devenir, 2023 Year-End HSA Research Report, 2023

For financial professional use only. Not for use with the public.

Myth #1: There's no HSA opportunity for financial professionals.

FALSE: Financial professionals embracing HSAs have an opportunity to differentiate themselves and enhance their value propositions. HSAs can also play a pivotal role as financial professionals look to provide holistic planning to capture the full opportunity set as wealth and retirement planning converge.

Generally, there are two ways for financial professionals to engage with HSAs—at the investor level and, as with qualified retirement plans, at the employer level.

Employer-Level Engagement

The available options for plan structure and compensation for financial professionals have evolved tremendously. HSAs reach consumers through a complex network involving multiple parties, including HSA trustees, benefits brokers, insurance companies, and employers. There is a material referral opportunity when partnering with benefits brokers and/or HSA providers since they work with employers and multiple insurance companies with the necessary HSA-eligible HDHPs.

According to a Plan Sponsor Council of America survey, 89 percent of employers offering HSAs rely on their benefits broker for the development of the HSA program while only 3 percent rely on financial professionals.[3] A key differentiator would be to help employers answer upfront questions about how they want their HSA programs to work such as

- What level of involvement does the employer want with the HSA program?
- Will the HSAs be employee funded, employer funded or both?
- If contributions are through payroll deferral, does the employer already have the requisite 125 Cafeteria plan in place?
- Does the employer want an automatic enrollment feature?

Insurance companies often promote a default or preferred HSA provider to their HDHP policyholders.[4] And 94 percent of the time, HSA providers set the investment options for the HSAs whereas financial professionals set the options just 3.5 percent of the time.[5]

Investor-Level Engagement

Additionally, there is ample opportunity for financial professionals to provide advisory services to individuals on their HSAs initially and ongoing, considering HSA owners are allowed unlimited transfers between HSAs and one rollover each year where no distribution trigger is required, such as separation from service.[6]

When individuals establish their HSAs, they must select investments for their contributions from the investment options offered by the financial organization offering the HSA. Some financial organizations offer just one HSA investment type (e.g., checking account, savings account, or share account). In contrast, some HSA providers offer a variety of investments, which may include time deposits with specified maturities (e.g., certificates of deposit, share term certificates) and other more 401(k)-like investments such as mutual funds, brokerage accounts and target date funds.[7] According to a study, the average HSA provider menu size is 21.[8] Offering multiple types of investments provides options that appeal to some HSA owners with longer-range savings goals, and guidance is essential. Other than life insurance contracts and certain collectibles, there is no other federal limitation on the types of investments HSAs can hold.

3. Plan Sponsor Council of America, 2023 HSA Survey
4. Consumer Financial Protection Bureau, Issue Spotlight: Health Savings Accounts, May 2024
5. Plan Sponsor Council of America, 2023 HSA Survey
6. IRS Publication 969
7. Devenir, "HSA Investment Menu Design Trends," May 2023
8. Ibid.

Myth #2: Financial professionals who guide employers or HSA owners are always fiduciaries with a conflict of interest.

FALSE: It is possible for financial professionals to provide HSA guidance that is purely educational in nature (and not advice). Adherence to Department of Labor's (DOL's) Interpretive Bulletin 96-1 is the safe harbor for providing educational guidance. Under this investment education exception, a financial professional could provide the following information and materials to HSA owners and employers that would not be considered investment advice subject to fiduciary standards. Such information includes

- Information and materials describing the HSA and how to contribute;
- Considerations around HSA participation;
- General financial information, such as around risk and return, diversification and risk tolerance; and
- Investment alternatives offered under the HSA, including information about fund strategies and objectives, risks, fees and expenses, trading restrictions, return potential information, and prospectuses.

It is true financial professionals who provide investment *advice* to employers who offer HSAs in conjunction with HDHPs or HSA owners and/or beneficiaries for a fee could be categorized as investment advice fiduciaries under the DOL's final rules, requiring them to meet strict standards of loyalty and prudence. Fortunately, the DOL has prohibited transaction exemptions (PTEs) available that allow financial professionals to be "good fiduciaries" and receive pay for their advice services without fear of running afoul of conflict-of-interest rules. In most cases, HSA professionals would follow the requirements of PTE 2020-02 to be compensated for their advice.

Myth #3: Not many people qualify to have an HSA.

FALSE: There are just a few eligibility criteria to have an HSA. An HSA-eligible family or individual is a person who is

- Covered under a qualifying HDHP with no other health plan,
- Not enrolled in Medicare, and
- Not eligible to be claimed as a dependent on another person's tax return.

The prevalence of HSAs is intertwined with HDHPs, and the number of employers offering HDHPs is rising. HDHP adoption has grown significantly in the last decade. As of 2023, 24 percent of workers with employer-sponsored health coverage were enrolled in an HSA-qualifying HDHP, up from 11 percent in 2013.[9]

Myth #4: HSAs are spending accounts that revert to employers if not timely depleted just like flexible spending accounts (FSAs).

FALSE: HSAs are *savings* not spending accounts that belong to their owners forever.

Most HSA owners (65 percent) believe HSAs and FSAs are the same, and their owners must spend the assets right away or lose them. On the contrary, unlike FSA assets, HSA assets always belong to the HSA owner and unused assets can roll over year after year—and between HSA providers—making them a great way to accumulate assets for use in retirement. In contrast, FSAs are accounts that belong to the employer, so they cannot leave the employer and unused amounts at the end of the year are forfeited to the employer.

9. "Employer Health Benefits Survey," Kaiser Family Foundation, 2023; and "Employer Health Benefits Survey," Kaiser Family Foundation. 2013

Myth #5: HSA assets must be ready for payment (liquid) and cannot be "invested" for long-term growth.

FALSE: HSAs can be invested for long-term growth and offer more tax benefits than 401(k)s.

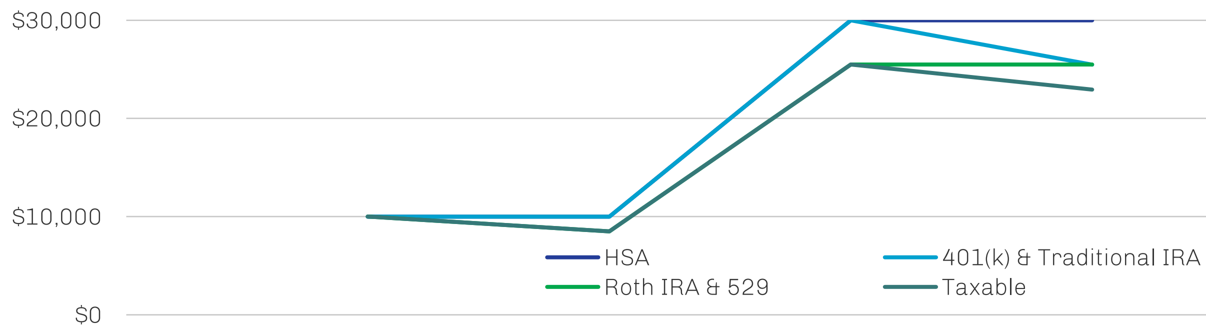
Because of the false belief that HSA assets must be timely spent, most believe the assets must remain liquid to facilitate distributions. A recent study revealed most HSA assets (67.5 percent) sit in cash accounts for immediate spending, and only a third of total HSA assets are invested. Only 18 percent of HSA owners invest their assets and of those, they only invest a portion (28 percent).[10]

Why the lack of long-term investing? HSA owners may be unclear of the benefits of using an HSA as a retirement planning tool. But HSAs are more akin to retirement savings accounts like a 401(k) plan than an FSA. In fact, HSAs are considered even better than a 401(k) from a tax and withdrawal perspective. Both 401(k)s and HSAs offer

- Tax-deferred savings (HSA contributions are even exempt from the Federal Insurance Contributions Act or FICA and Federal Unemployment Tax Act or FUTA withholding), and
- Tax-deferred growth.
- Tax-free distributions.

HSAs go one step further than 401(k)s to offer a third benefit—tax-free distributions if used for qualifying medical expenses. HSA owners get a triple tax treat not available with any other type of savings vehicle. And, unlike 401(k) plans, HSAs are not subject to required minimum distributions (RMDs).

HSA Triple Tax Treat



		Pretax Amount USD	Value After Contribution USD	Investment Growth USD	Withdrawal Amount USD
Tax Implications	HSA	Tax-deductible	Tax-free	Tax-free	
	401(k) & Traditional IRA	Tax-deductible	Tax-free	Taxed	
	Roth IRA & 529	After-tax	Tax-free	Tax-free	
	Taxable	After-tax	*	Taxed	

Chart is for illustrative purposes only.

Source: Morningstar, 2023 Health Savings Account Landscape, October 2023.

© 2024 Morningstar, Inc. All Rights Reserved. Reproduced with permission.

Beyond confusion, HSA owners are unlikely to invest their assets for other reasons, too. For example, while 60 percent of HSA providers offer investment options, 84 percent of them impose a minimum balance requirement before assets can be invested.[11] Another key hindrance to investing is the complexity and cost of the investment options offered. HSA investment menus

- Are controlled by the third-party provider;
- May be subject to costly and complex provider fee structures;
- Are likely unfamiliar to investors;

10. Plan Sponsor Council of America, 2023 HSA Survey
11. Plan Sponsor Council of America, 2023 HSA Survey

- They differ from 401(k) core menus by design; and
- Can include brokerage accounts, which are confusing to many investors.[12]

Further, HSA owners experience a lack of investment support. While employees could establish their HSAs with any authorized HSA provider, or at least transfer their employer-provided HSA to an HSA provider of their choosing, most employees use the HSAs offered by their employers and their benefits broker. Benefits brokers focus on the health insurance policies—not HSAs. For many benefits brokers,

- HSAs are not their area of expertise;
- They are not set up to handle participant questions; and
- HSAs are not a source of compensation for them.

Human resources (HR) departments, too, lack expertise in HSAs. So, the chance that an HSA owner could get guidance from their HR representative is slim.

Myth #6: HSA contribution limits are so low—the account will never amount to much.

FALSE: As mentioned previously, HSAs offer a triple tax treat: 1) tax-deferred contributions, tax-deferred savings and tax-free distributions for covered medical expenses. With time, that makes them a powerful retirement planning tool. Look at the following example.

EXAMPLE

Newly employed reporter, 25-year-old Clark Kent, uses a HDHP and HSA at his workplace. He contributes the annual maximum amount ($4,150 for 2024) for 40 years—until he reaches age 65.[13] Clark is "low-maintenance" when it comes to health issues and decides to pay for medical costs out of pocket through the years so his HSA can continue to grow tax-deferred. Clark is a "shoe-boxer," and dutifully saves all his receipts. After 40 years of investing without withdrawals, the value of Clark's HSA reaches nearly $515,000.

Considering at age 65, the average household will incur, on average, $310,000 in health care spending over the remaining lifetime, Clark's HSA has done its duty and then some.[14]

After 40 years you could have $514,790.29

Balance by Year in Thousands of Dollars

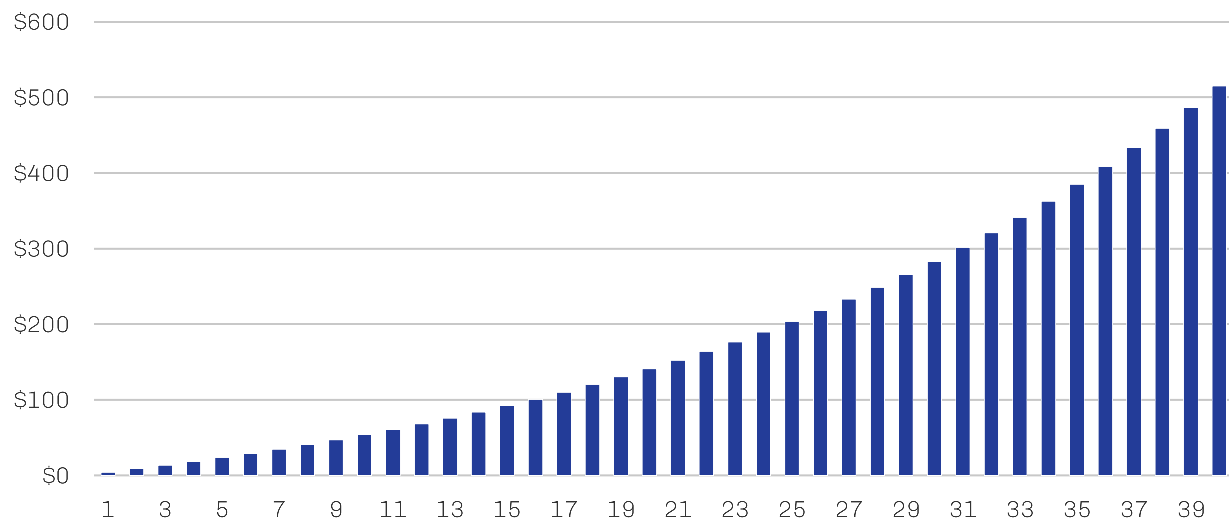


Chart is for illustrative purposes only and not meant to predict actual results. Assumes hypothetical 5% rate of return, 24% marginal tax bracket[15].

12. Consumer Financial Protection Bureau, Issue Spotlight: Health Savings Accounts, May 2024
13. Note that at age 55, Clark is eligible for an additional $1,000 catch-up contribution, which will increase his overall savings.
14. Center for Retirement Research at Boston College, "How Much Do Retirees Spend on Uncertain Health Costs?" 2022
15. Source: https://www.umb.com/hsa/resources/calculators/hsa-savings-calculator

Myth #7: HSA investing is the same as investing with a broader retirement portfolio.

FALSE: While an HSA saver may have the opportunity to invest his or her savings in a similar manner to their broader retirement savings portfolio, there is an important consideration when selecting an HSA investment portfolio. That consideration is there may be an immediate need for health care spending. Given the tax-free status of distributions, tapping an HSA distribution may be a better option for some, rather than taking a qualified retirement plan early distribution, loan, or hardship withdrawal from a qualified retirement savings plan. Early distributions and hardship withdrawals from qualified retirement plans may face income taxes and potential penalty taxes. When investing HSA savings, a saver may wish to consider investments that are designed to provide long-term growth potential and downside mitigation potential during significant downturns in capital markets.

Myth #8: An HSA goes away at age 65.

FALSE: That myth persists because of Medicare coverage. The assets in an HSA are the owner's forever and, as long as he or she is not enrolled in Medicare and remains covered by an HSA-qualified plan, the HSA owner can continue making HSA contributions. For example, a person can delay enrollment in Medicare Parts A, B, C, and/or D until he or she retires if the person (or spouse) is still actively working for a company with at least 20 full-time workers and covered by employer-provided health insurance.[16]

Because Medicare is not an HSA-qualified health plan, a person cannot enroll in Medicare and contribute to an HSA. However, the HSA remains after Medicare coverage, and assets can still be used to pay for qualified medical expenses. In fact, HSA assets can be used to cover Medicare premiums for Parts A, B, C and D in retirement (but not premiums for Medigap coverage). [17]

Further, after age 65, regardless of Medicare coverage, an HSA owner may use HSA distributions to pay for nonmedical expenses without incurring the 20 percent penalty, provided the HSA owner includes the distribution in taxable income. Distributions that cover qualified medical expenses are always tax and penalty free.

EXAMPLE CONTINUES

Let's say Clark had $120,000 of accumulated health care expenses over the 40 years. Since he still has all his receipts, he can, from his HSA, reimburse himself the $120,000 that he paid out of pocket (tax- and penalty-free) and still have nearly $400,000 remaining to cover health expenses in retirement. Further, now that Clark is 65 years old and covered by Medicare, although he can no longer contribute to his HSA, he can take distributions for reasons other than to cover health expenses without the stiff 20 percent early withdrawal penalty, as long as he includes the amounts taken for nonmedical purposes in his taxable income.

Myth #9: Why invest in an HSA—I can't leave it to my beneficiaries.

FALSE: If the spouse is named as the HSA's beneficiary, the HSA is treated as the surviving spouse's own HSA at the time of the original HSA owner's death. The surviving spouse enjoys the same features as the original owner.

Nonspouses can be listed as HSA beneficiaries, too. However, they must receive a complete payout of the HSA assets in the year of death, which they must include in taxable income—a windfall one might say. The good news is the 20 percent penalty tax is waived.

16. https://www.medicareinteractive.org/get-answers/coordinating-medicare-with-other-types-of-insurance/job-based-insurance-and-medicare/health-savings-accounts-hsas-and-medicare
17. IRS Publication 502, Medical and Dental Expenses

Myth #10: HSA investing is an all-or-nothing deal. I have immediate healthcare needs for the dollars, so I cannot risk or lock-up all the assets.

FALSE: HSA investing is not an all-or-nothing arrangement, depending on the HSA provider. Owners can keep a portion of their assets in a cash or other liquid account for immediate needs, while investing the remainder for long-term growth. Downside mitigation potential and preserving purchasing power are still important aspects of portfolio management.

Other than life insurance contracts and certain collectibles the IRS does not limit the types of investments that can be offered for HSAs. Yet, some financial organizations offer just one HSA investment, typically a "cash-type" account such as a checking account, savings account, or share account. Other HSA providers offer a variety of investments, in addition to cash accounts, which may include time deposits with specified maturities (e.g., certificates of deposit, share term certificates) and other investments like mutual funds and brokerage accounts. Offering multiple investments provides options that appeal to HSA owners with long-term savings goals.

According to Morningstar, when using an HSA as a spending account to cover current healthcare costs, some of the better HSAs do the following:

- Offer accounts without maintenance fees regardless of account size.
- Pay reasonable interest rates on deposits.
- Eliminate or limit additional fees.
- Offer FDIC insurance on the account.

When using an HSA as an investment account to cover future healthcare expenses, research indicates that some of the better HSAs follow these practices:

- Offer investment strategies in all core asset classes while limiting overlap.
- Provide historically strong investment strategies.
- Charge low fees for active and passive strategies.
- Do not require investors to keep money in spending accounts before investing.[18]

Conclusion

After 20 years, it seems HSAs are undergoing a sort of revelation. Long viewed exclusively as short-term spending accounts for immediate health expenses, a second glance reveals they can also be effective long-term savings and investing accounts for retirement, if appropriate. This alternative identity presents additional opportunities for HSA owners in their financial planning strategies and financial professionals looking to differentiate their practices. The seemingly mild-mannered HSA also can be one vehicle to consider for retirement savings.

18. Morningstar, The Best HSA Providers of 2023, October 2023

Disclosures

The opinions expressed are not necessarily those of the firm. **These materials are provided for informational purpose only**. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Any statistic contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation or an offer to buy or sell or the solicitation of an offer to buy or sell any fund or security.

This material is for informational purposes only and is not to be construed as specific tax, legal, or investment advice. You are strongly encouraged to consult with your independent financial professional, lawyer, accountant or other advisors as to investment, legal, tax and related matters.

© 2024 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; (3) does not constitute investment advice offered by Morningstar; and (4) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. Use of information from Morningstar does not necessarily constitute agreement by Morningstar, Inc. of any investment philosophy or strategy presented in this publication.

Definitions

Health Savings Account (HSA) is a tax-advantaged savings account covering certain healthcare costs for their owners enrolled in qualifying High Deductible Health Plans (HDHPs).

High Deductible Health Plans (HDHPs) is a health insurance plan with lower premiums and higher deductibles than a traditional health plan.

Federal Insurance Contributions Act (FICA) requires employers to withhold a certain percentage of an employee's wages to help fund Social Security and Medicare.

The **Federal Unemployment Tax Act (FUTA)** imposes a payroll tax on businesses with employees, collecting revenue that funds unemployment benefits.

A Flexible Spending Account (FSA) is a tax-advantaged savings account that allows employees to pay for health-related costs with pretax dollars.

Morningstar is a leading source of data, research, and insights for investors.

Required Minimum Distributions (RMDs) are the minimum amount someone must withdraw annually from certain retirement accounts to avoid a tax penalty.

A 401(k) plan is a retirement savings plan offered by many American employers that has tax advantages for the saver.

A **125 Cafeteria Plan** is a written plan that allows employees to elect between permitted taxable benefits (such as cash) and certain qualified benefits.

PTE 2020-02 is a prohibited transaction exemption under ERISA and the Code for investment advice fiduciaries with respect to employee benefit plans and individual retirement accounts (IRAs).

Risk Disclosures

All investments involve the risk of loss of principal.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Past performance is not indicative of future results.

FEF Distributors, LLC ("FEFD") (SIPC), a limited purpose broker-dealer, distributes certain First Eagle products. FEFD does not provide services to any investor, but rather provides services to its First Eagle affiliates. As such, when FEFD presents a fund, strategy or other product to a prospective investor, FEFD and its representatives do not determine whether an investment in the fund, strategy or other product is in the best interests of, or is otherwise beneficial or suitable for, the investor. No statement by FEFD should be construed as a recommendation. Investors should exercise their own judgment and/or consult with a financial professional to determine whether it is advisable for the investor to invest in any First Eagle fund, strategy, or product.

First Eagle Investments is the brand name for First Eagle Investment Management, LLC and its subsidiary investment advisers.

© 2024 First Eagle Investment Management, LLC. All rights reserved.