



## Episode 7:

# HSAs: The best option for retirement savings?

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**Stephen Durso:** Two things are going to be objectively true for your future. You are going to have significant out-of-pocket expenses in your Medicare years, and your HSA dollars will go further than your 401(k) dollars in paying those expenses.

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**Announcer:** You're listening to Benefits, with Purpose!, a Willis Towers Watson podcast where benefits delivery experts help employers navigate the world of health and wealth benefits and deliver purpose to their people in the moments that matter most.

**Philip Massey:** Hello. My name's Philip Massey. I've spent over 20 years in employee benefits, and I'm thrilled to be part of bringing you another episode in our Benefits, with Purpose! series entitled "HSAs: the Best Option for Retirement Savings?" With me today to discuss how HSAs fit into your approach for retirement, it is our resident health savings accounts expert Stephen Durso, Associate Director at Willis Towers Watson. Good morning, Steve.

**Stephen Durso:** Good morning, Phil.

**Philip Massey:** So Steve, I know you live health savings accounts each and every day. If I'm someone trying to better understand my HSA, however, what would you say is the least understood aspect of the benefit?

**Stephen Durso:** Well, Phil, definitely understanding it as a retirement vehicle, particularly that it's likely the best retirement savings option available to employees, even better than a 401(k).

**Philip Massey:** Really? Better than my 401(k) for retirement? How so?

**Stephen Durso:** Well, Phil, let me answer your question with a question. How much money do you think you'll need in retirement for medical expenses? Think about how much out-of-pocket spending will you have in your Medicare years.

**Philip Massey:** Well, let's see. I'll likely work till age 65, you know, have Medicare by then, so not too much, right?

**Stephen Durso:** Well, would you be surprised to know that if you retired today at 65 with Medicare and you were married, over the next 20 years, you would expect to pay about \$320,000 out-of-pocket for you and your spouse?

**Philip Massey:** Wow. That's with Medicare I'm spending with \$320,000?

**Stephen Durso:** That's right. So assuming premiums, out-of-pocket expenses for Medicare Part B or a Medigap plan, Medicare prescription drug coverage, and Med D, all of that together comes to \$320,000 on average.

**Philip Massey:** OK, that's probably more than most people are planning for. That's certainly surprising the first time you hear it.

**Stephen Durso:** You know it is. And what a lot of people will do with their HSA is they'll enroll in a high deductible health plan, open that HSA, maybe their employer's giving them a seed or an incentive if they do some type of wellness activity. Free money is a pretty basic concept that employees do understand, and that does tend to get people to enroll.

But, over time, when they start looking at it, they start to figure out that they need to consider their plan's deductible, so high deductible health plan naturally come with higher deductibles, and they should probably contribute up to the point to meet that deductible. However, you know, once they start looking at it a little bit more, if they're savvy, they may understand that an HSA is an excellent vehicle to save for retirement as well.

**Philip Massey:** Yeah. But I can see how you get lost there. I bet most employees, especially as they're getting started, are thinking in silos that the HSA is really for health care now and the 401(k) is more for retirement later.

**Stephen Durso:** And, you know, that's a common misperception. So I think another question I would have for you is, what happens when you take money out of your 401(k) to pay for a medical expense?

**Philip Massey:** Oh, yeah. Once you're Medicare eligible, even as you're taking money out of your 401(k) to pay for a given medical expense, or any expense for that matter, from a 401(k) is taxed as income.

**Stephen Durso:** That's exactly right. But remember, that's not true for an HSA. So for an HSA, we always talk about the triple tax advantage. So that's three different things; so you contribute tax-free, you can earn and invest tax-free, and then, when you finally need the funds, you can take it out tax-free. So as long as you're using it for a medical expense, it will be tax free. So when you're paying for that \$320,000, those withdrawals would not be taxable, which is a great benefit that is not available out of the 401(k).

**Philip Massey:** Interesting. So dollar-for-dollar then, it seems my money goes further with an HSA than a 401(k) when I'm spending those dollars in retirement after age 65.

**Stephen Durso:** That's right. So consider that you have that \$320,000 out there for your retiree's spend on medical. Your 401(k) is going to be tax deferred, meaning that you'd only pay taxes when you withdraw money. But your HSA funds are never taxed so long as you use them for eligible medical expenses.

If you think about it more, think about those federal, those state income taxes in retirement, if you're spending your money out of your HSA, that means that if you have a 12%, 22%, 24% tax rate, whatever your taxable income rate is in retirement, that money stays in your pocket because you won't have to use it on taxes if you have access to that HSA.

**Philip Massey:** Now that's a really important fact to understand. If I'm hearing you, I'm avoiding taxes cutting in to the dollars I withdraw from my HSA for the eligible medical expenses. So if I have \$100 medical bill, for example, I'm spending \$100 for my HSA, but a comparable withdrawal from my 401(k) for \$100 could actually cost me, say, \$124 due to the taxes I'll have to pay on that withdrawal.

**Stephen Durso:** That's right.

**Philip Massey:** That's interesting. Ok, so what if I make the argument that I'm extraordinarily healthy? There's no way my wife and I would need that \$320,000. We've been doing our yoga. We're eating better. All of that. So what if my bogey ends up not really being \$320,000?

**Stephen Durso:** Well, first, Phil, I'd like to congratulate you on your life choices. Those sound like some good choices.

**Philip Massey:** Thank you.

**Stephen Durso:** But after 65, you can still spend your HSA on non-medical expenses, and there's no tax penalty. You would just have to pay taxes as income. So there's no longer an additional penalty where there would be if you tried to take money out for any purpose prior to 65 in an HSA. Once you're 65, that extra penalty tax goes away.

**Philip Massey:** Oh, Ok. So if I put all of this together then for medical expenses, on average, we said \$320,000 needed for retirement, the HSA is a better deal because I pay no taxes when I'm spending that money. But even worst case, you're saying that considering spending for a non-medical expense, the HSA is no worse than even with the 401(k) as the withdrawals are taxed as income when they come from either account in that circumstance.

**Stephen Durso:** That's right. So again, there's just no penalty for non-medical spending after age 65. So that withdrawal for non-medical service would be taxed as income just like a 401(k). So if you are that super healthy person post-65 and you don't end up having \$320,000, you could still take your money out of your HSA. You could use it on a trip in a hot air balloon around the world, and you would just pay income taxes on it. There would be no penalty.

**Philip Massey:** That's exciting. Yeah, you know how I plan. That's exactly what I'm looking forward to. That's all great to know, but you have just complicated my retirement planning. So now I have to piece together both my 401(k) and my HSA into a cohesive retirement strategy.

**Stephen Durso:** That's true. But the considerations aren't really that complicated if you break them down into smaller pieces. So the first thing I would say is that everyone's individual situation is a little bit different, so you really should get with a financial planner to pull together a strategy appropriate for you, including your HSA and 401(k).

But to start. Think about your employer's contributions to both plans, so 401(k) match, maybe there's an incentive for the HSA. For both of those plans, what do you need to do in order to get that free money and not leave any of it on the table? That's really your key at first.

Then after you go through that, take a good look at prioritizing your HSA. So two things are going to be objectively true for your future. You are going to have significant out-of-pocket expenses in your Medicare years, and your HSA dollars will go further than your 401(k) dollars in paying those expenses.

**Philip Massey:** Sure. That all makes sense. But even to do that, I still need to keep some money on hand for my current health care expenses today, right?

**Stephen Durso:** That is true. So a couple tips there. So you can always look at your last year's spending on health care, on doctor's visits, prescriptions, try to estimate what you might expect this year. You can think about your plan's deductible-- how long before the plan benefits actually kick in-- and then you want to try to keep enough in that cash account to cover those kinds of expenses. But then also you really should consider it as part of a savings vehicle too.

So, generally, HSAs would allow you to start investing once you have a certain balance, like maybe \$1,000 or something around there. So, ideally, you'd want to start investing that money and earning as long as possible to take advantage of the time you have until retirement. But it is definitely possible to work along parallel tracks to build up both your cash account for your current expenses as well as your investment balance for your long-term financial wealth.

**Philip Massey:** Ok, the value of the HSA long term is a little more clear conceptually. Medical expenses in retirement are significant. I get that. HSA dollars go further than a comparable 401(k) dollar as the withdrawals are tax-free.

And I can invest the HSA dollars to grow that nest egg, but I do have to keep in mind the ongoing out-of-pocket health care expenses along the way during my active years. So I see the potential, but I do need to keep some money sort of outside of that universe as well. So I have a family with expenses, and now and again I like to have a little fun, right?

**Stephen Durso:** Well, think about it this way. So what does it mean to contribute an extra \$1,000 annually to your HSA?

**Philip Massey:** Yeah, so that means I have to come up with another \$1,000.

**Stephen Durso:** Yes, but in terms of payroll deduction, you may want to think of it another way. If you're paid twice a month, that's only going to be 40 bucks a paycheck. Also you want to consider that the contributions going in are pre-tax, so you're probably missing closer to \$30 in take-home pay to put in that \$40. So, Phil, you know, if you skip a couple of those fancy coffees, the future Phil will be grateful.

**Philip Massey:** You know, I love my fancy coffee. That's asking a lot.

**Stephen Durso:** Well, you know, even if you cut it in half. Maybe just don't get it every single day. Switch to every other day. If you do \$20 more per paycheck, which would be about \$15 in take home pay, that's still going to give you \$500 more per year.

**Philip Massey:** Sure. Ok, so I get it. It's not as insurmountable as it seems. Now, before we go, however, let me ask you this question. I'm still a little hesitant. Do I really want all of my money tied up in an account I can only use for medical expenses before age 65? It feels very limiting to have all of my eggs in that basket.

**Stephen Durso:** Sure. So, you know, there is an easy answer to that that's often overlooked, and this is just another example of how HSAs offer flexibility. You could almost consider it a pro tip. So you can think of it as banking your medical plan, so it's a way to turn your HSA into a sort of emergency fund. And here's how it works. Still the instructions that we give all the time are the same to start-- put that money away in your HSA. If you can max out your HSA, you should definitely do that and get that money in there. You want to invest it and build for the future.

The next thing, though, is a little bit different. So this strategy would be to pay for your medical expenses while you're working and while you're young out of your pocket. So whenever you can, don't touch your HSA, if you can avoid it. So if you have one of those HSA cards, do not swipe it-- actually pay for your medical expenses out of your pocket.

That money that you're leaving in your HSA and not using will continue to grow. If you have it invested, it will grow that way as well. One important thing, though, when you do have those medical expenses is to save your receipts because they will be needed later. So if you have an emergency down the line, it can be any emergency, just give me one, Phil.

**Philip Massey:** Ok, sure. Someone in the family wrecks a car. I've got a little experience with that. They're Ok physically. It's not a medical emergency, but the car itself is totaled.

**Stephen Durso:** Well, I'm glad everyone's Ok, Phil. But you have a non-medical emergency. So it may not be your first impression that you could use the HSA to help you out of that situation, but, in fact, there is a way that you can. So you have a down payment on another car, and all of your money is tied up in that HSA. So, Phil, what have you been doing with your medical expenses all this time?

**Philip Massey:** I've been paying it out-of-pocket, saving my receipts.

**Stephen Durso:** Excellent. So you've been paying out-of-pocket and you've been building up those receipts, so you have not been paying from the HSA. So the wonderful thing about HSAs is there is no deadline for cashing in those receipts. There's still valid medical expenses even 5, 10, 20 years later.

So if you have \$5,000 in receipts from the past 10 years and you established your HSA 10 years ago, you can withdraw those funds today to pay for your down payment on a new car. So this really is an option that many people are not aware of but can really help you out in having a pot of money that you can access tax-free, basically, because you've already had the medical expense years ago.

**Philip Massey:** Wow. That's allowed?

**Stephen Durso:** Sure, as long as you have the receipt, so critical that you're saving those receipts. And the best part is that money went in tax-free, so you've probably saved 30% right there. If you're investing, those dollars are earning for you along the way. And even though you've had to pull some money out, the earnings and tax savings have created significantly more wealth for you over time-- again, your initial tax savings plus your rate of return from your investments.

**Philip Massey:** Wow. The HSA really has some unique benefits to it. So I get the tax savings on the front end, the savings and investing for retirement, the growth of dollars over time, and the ability to bank my medical expenses, as you just explained. You know, I remember years ago when my 401(k) was a bit of a mystery as I was entering the workforce, and it feels like that all over again.

**Stephen Durso:** Yeah. You know, I hear you, Phil. The best thing about HSAs is there's so much inherent benefit to them, but a lot of times it's easy for employees to focus solely on their immediate spending benefits. But what we say is that the S in HSA stands for "savings," and it really is one of if not the best retirement vehicles available to most employees-- even better than a 401(k). Your health savings account is truly an asset in your portfolio, not a liability.

**Philip Massey:** Looking at it as an asset and not a liability, that's a great way to think about it. That's all the time we have for today. Steve, thank you so much for your insight on the flexibility of HSA benefits. The concepts you shared are critical for employees to understand. The HSA presents an opportunity to grow wealth for retirement that's just too good to miss out on.

**Stephen Durso:** Thanks, Phil.

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**Philip Massey:** And thanks to our Benefits, with Purpose! listeners. Make sure you subscribe and join us for future episodes and we look forward to seeing you next time. Be well all.

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