Maximum Utility: Your HSA Can Do Quadruple Duty

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More than ten years ago, most plan sponsors tended to agree with then-President Obama that health savings accounts (HSAs) offered limited value to only a minority of people in the United States.

During a February 2010 health reform summit, Obama said: " . . . health savings accounts, I think, can be a useful tool, but every study has shown that the people who use them are folks who've got a lot of disposable income. And the people that we're talking about don't."

AT A GLANCE

- Once considered useful to a minority of people in the United States, thinking around health savings accounts (HSAs) has evolved into the theory that they can be used as part of a "health and wealth" rewards strategy.
- In addition to funding current or future medical costs, HSAs can be used to pay for Medicare premiums and as retirement income. They also can be passed on to beneficiaries after the account holder's death.
- More items qualify as eligible expenses under HSAs than under flexible spending accounts (FSAs), and HSAs offer more value than 401(k)s when using the accounts to pay for retiree medical expenses.
- Plan sponsors that want to increase enrollment in HSA-capable plans should consider communication and enrollment strategies that combat behavioral decision-making biases, including the anchoring and status quo biases.

More recently, HSA thinking has evolved to become part of a "health and wealth" rewards strategy.[1] Because medical costs may be the largest expense in retirement, some now view HSAs as a vehicle for retirement preparation. In my last plan sponsor role, we first adopted HSA-capable coverage in 2005. An initial objective was to provide a tax-favored opportunity to fund retiree medical costs for those who enrolled, met all the eligibility conditions and contributed to an HSA.

However, the last 16 years have mostly been a missed savings opportunity.[2] Most employers don't offer HSA-capable coverage. Most employees don't enroll in HSA-capable coverage when it is offered as a choice—even when it is the better option. Many enrolled in HSA-capable coverage fail to open the HSA account. Few maximize their HSA contributions. Only a minuscule minority invest HSA assets beyond capital preservation.[3]

So, if an employer's goals include maximizing the utility that HSAs offer, it is well past time for revolutionary (not evolutionary) thinking.

HSA Utility—The Swiss Army Knife™ or Leatherman® of Employee Benefits

The HSA reminds me of a Swiss Army Knife or a Leatherman tool.[4]

HSAs offer tax-preferred utility capable of quadruple duty:

1. **Now** (before retirement)—Fund current or future medical, dental, vision, hearing and long-term care (LTC)

expenses, Consolidated Omnibus Budget Reconciliation Act (COBRA) coverage premiums and LTC premiums

2. **Future** (retiree medical costs)—The same as above, plus Medicare Part B and D and Medicare Advantage premiums
3. **Beyond medical costs** (retirement income)—HSA assets withdrawn after age 65 to qualify for tax preferences that exceed those of the 401(k). (Contributions are pretax for FICA and FICA-Med.[5])
4. **Legacy** (no forfeitures)—A surviving spouse who is the designated beneficiary can continue the account. A nonspouse, nondependent designated beneficiary will ultimately receive any residual as a taxable payout.

The following compares some of the advantages that HSAs offer with other benefits or income tax strategies.

- **HSAs vs. flexible spending accounts (FSAs)**: More items qualify as eligible expenses under HSAs than under FSAs. FSAs are subject to "use or lose" forfeitures, whereas HSA assets remain in the account. HSAs have higher contribution maximums than FSAs.[6] Unlike FSAs, participants can change HSA contributions midyear without a change in status, and many HSAs qualify for employer contributions. HSAs need not be fully funded in advance or with irrevocable elections prior to incurring qualifying expenses.[7] Finally, unlike FSAs, HSAs offer investments capable of funding future, postseparation, and retiree out-of-pocket costs and premiums.[8] Table I offers more details.
- **HSAs vs. itemized tax deductions:** Fewer Americans itemize federal tax deductions since the Tax Cuts and Jobs Act of 2017 raised the standard deduction and limited the deductibility of state and local taxes. Itemized medical expenses don't qualify for tax-favored treatment when it comes to state income taxes, FICA and FICA-Med.[9]
- **HSAs vs. 401(k)s:** HSAs avoid FICA and FICA-Med taxes. When used for retiree medical expenses, HSAs offer 60+% more value.[10] Optimum value may occur where participants use both accounts. Tables II and III offer additional comparisons of HSA and 401(k) features.

TABLE I

Health Savings Accounts (HSAs) and Flexible Savings Accounts (FSAs), Saving vs. Spending

	HSAs	FSAs
Enrollment/Ownership	Indefinite, not employer linked	Annual enrollment, employer linked
Contributions	Always 100% vested	"Use or lose"
Investment of Contributions	Allowed, tax-deferred	Not allowed
Funding	Trusteed	Notational account
Tax-Free Eligible Expenses	Include Medicare premiums, employer-sponsored Medicare supplement premium, long-term care (LTC) out-of-pocket expenses and premiums, COBRA premiums, health insurance premiums while unemployed	Cannot fund Medicare, LTC or COBRA premiums or health insurance premiums while unemployed
Taxable Payouts	Allowed	Not allowed
Carryover of Account Balance	Allowed	Allowed, subject to limits
Portability	Fully portable	Not portable

If You Build It, Many Won't Enroll Unless You Also Deploy Automatic Features

Unfortunately, most plan sponsors deploy annual enrollment processes that focus worker attention only on predictable needs in the coming year. Many plan designs fail to anticipate the diverse needs of the workforce—today and tomorrow. See the sidebar "A Valuable Lesson." As we learned in 2020, the future can be unpredictable.

Many workers do not select HSA-capable coverage even when it offers them better value. Unfortunately, when a plan sponsor adds an HSA-capable option, many fail to address impediments to enrollment, including the following.

- **Anchoring bias, part 1:** Deductibles are prominent, especially when incorporated in the name of the option (e.g., the $1,500 option, the "high-deductible" option). For comparison, 401(k) plans were once called "salary-reduction savings plans." Such HSA naming conventions focus an inordinate amount of attention on the deductible and skew enrollment away from HSA-capable coverage.
- **Anchoring bias, part 2:** Few plan sponsors highlight expenses beyond the coming year or postemployment in their annual enrollment communications and decision making.

TABLE II

Health Savings Accounts (HSAs) vs. 401(k)s

	HSAs	401(k)s
Ownership	Indefinite, lifetime, survivor	Indefinite, lifetime, survivor
Vesting of Contributions	Always 100%	Employee contributions always vested, varies for employer contributions
Investment of Contributions	Allowed, tax-deferred	Allowed, tax-deferred
Employer Contributions	Common	Common
Tax-Free Eligible Expenses	Many	None
Taxable Payouts	Allowed	Allowed
Loans	Not allowed	Allowed
Catch-Up Contributions	Allowed for employee and spouse who are 55+	Allowed only for employee who is 50+
Roth Contributions	Not allowed	Allowed
Tax Treatment of Contributions	Pretax for federal and state income taxes, FICA and FICA-Med	Pretax for federal and state income taxes
Portability	Fully portable	Usually portable after age 59½ or postseparation
Distribution Requirements	No required beginning date (RBD) or required minimum distribution date (RMD)	Subject to RBD/RMD regulations

- **Anchoring bias, part 3:** Few plan sponsors offer a savings target for future HSA-eligible expenses (e.g., estimates of premiums for Medicare or for employer-sponsored, fully insured, retiree-pay-all Medicare supplement or Medicare Advantage coverage).
- **Anchoring bias, part 4:** Few plan sponsors position HSA-capable coverage against the minimum requirements of health care reform (e.g., affordable, minimum essential coverage of minimum value).
- **Availability heuristic:** Many plan sponsors assign a larger out-of-pocket expense maximum to the HSA-capable option compared with preferred provider organization (PPO) and/or health maintenance organization (HMO) alternatives. Participants tend to overestimate the likelihood of events with greater "availability" in memory, influenced by how unusual or emotionally charged they may be.
- **Complex comparisons, part 1:** A typical summary of benefits and coverage presents an incomplete, general comparison that excludes employee contributions. Many plan sponsors focus HSA education on taxes, contribution limits and general deductible. Few market HSAs via personalized comparisons.
- **Complex comparisons, part 2:** The HSA-capable coverage provider network may differ from those of PPO or HMO alternatives.
- **Cost sharing:** Where company contributions are determined as a percentage of premium (vs. the same dollar amounts for all options), higher cost options may receive greater levels of employer financial support.
- **"Deductiphobia" (the fear of deductibles):** A plan with copays may appear to be more valuable but may lead to over-insurance. In fact, less than 10% of Americans incur out-of-pocket expenses that exceed the minimum single deductible for HSA-capable coverage.[11] Comparisons are difficult because most plan sponsors fail to adjust PPO or HMO coverage to reflect the same general deductible structure required for HSA-capable options.
- **No transitions:** Those living paycheck to paycheck may not be prepared to meet the deductible where expense is incurred early in the plan year. Most plan sponsors don't offer transitions (e.g., front-loading an employer contribution when first enrolling in HSA-capable coverage or providing tax-favored, low-cost financing options).

TABLE III

Health Savings Account (HSA) or 401(k)?

The following compares the impact of reducing take-home pay by $1,000 per year from age 30 to 64 and investing it in an HSA vs. investing it in a 401(k). It assumes the account earns 6% annually and there is no change in marginal tax rates throughout the period. Payouts are in 25 equal installments from ages 65 to 90 to reimburse medical premiums and expenses.

	HSA	401(k)
Annual Deposit*	$ 1,603	$ 1,429
Balance at Age 65	$183,989	$164,017
Annual Payout to Age 90	$ 14,396	$ 12,833
Annual After-Tax Value to Age 90	$ 14,396	$ 8,983
Difference in Value	**60.3% more**	

*Assumes a 25% federal, 5% state, 6.2% FICA and 1.45% FICA-Med marginal rate.

- **Status quo bias:** Under Isaac Newton's first law of motion, "A body at rest will stay at rest until a net external force acts upon it." Too many plan sponsors leave existing annual enrollment elections in place as the default when first adding an HSA-capable option.

Unfortunately, whether it's 401(k) plans or HSAs, most workers don't do a lot of planning or spend much time/effort/resources on benefits decision making. Few anticipate diverse needs and prepare for today and tomorrow.

Health plan sponsors should reconsider how HSA-capable coverage is presented. Evolution has not prompted widespread HSA enrollment or changes in HSA savings habits. Revolutionary thinking would follow the well-trodden path of 401(k) plans by deploying automatic features. Plan sponsors that adopt automatic features shouldn't limit them to new hires. Revolution would include changes in decision making and choice architecture, such as:

- Conducting full-positive annual enrollments
- When individuals elect medical coverage, using the HSA-capable option[12] and a positive contribution amount as defaults, forcing workers to opt out if they want a different coverage option[13]
- Opening the HSA on the first day of coverage with a nominal employer contribution; get the claims clock running
- Adding midyear HSA reenrollment and escalation processes[14]
- Changing the default investment from capital preservation to longer term investments.[15]

Utility Beyond Quadruple Duty

Following are a few last thoughts about HSAs and the unique utility they offer.

- **Year-end tax planning:** Adopt an(other) HSA-capable coverage option each and every December 1 using a 13-month deductible to give workers a last clear chance to enroll in and fund an HSA and to max out two years of contributions despite the 13-month period of coverage.
- **Wellness benefit:** Good health is rewarded. HSA assets not spent on health care may offer greater value in retirement than a comparable amount of 401(k) assets.
- **Death benefit:** HSA assets are a legacy benefit. They are vested immediately and never forfeited. Plan sponsors should perennially encourage HSA owners to review and update their beneficiary designations.
- **Antiselection:** Deductiphobia can operate as an antiselection sentinel. Offering HSA-capable plans may help firms avoid hiring workers who are seeking employment with a firm that offers generous medical coverage.
- **Managing enrollment:** Lucrative, expensive, high-value, low-deductible medical coverage may place employers at a competitive financial disadvantage if they end up covering more employees, spouses and dependents who had a choice of coverage under a spouse's or parent's employer-sponsored plan.
- **Income tax averaging:** HSA contributions can be timed to occur in periods with high marginal federal and/or state income taxes. Because there are no required minimum distributions, participants control the account and timing of payouts (retirement, unemployment, relocation to a state with lower/no income taxes, etc.).
- **Executive benefits:** Employers should compare HSA capability against costly, insured, executive coverage. Employers that already offer executive coverage shouldn't wait for health reform to eliminate it.[16] Executives may have varied preferences, including the following.
  - —Some would use any added spend to provide first-dollar coverage while employed.
  - —Others might prefer to accumulate assets to moderate or fund income-related monthly adjustment amount (IRMAA) Medicare premiums.
- **Emergency accounts:** Most people in the U.S. worry about medical bills. Some deny themselves needed care. HSA assets have the potential to improve wellness by funding these expenses, COBRA premiums[17] and/or medical premiums while unemployed.[18]
- **Aggregator/consolidator:** Perennially soliciting HSA rollovers may remind HSA owners of the value from consolidating HSA assets, especially where a capital preservation minimum investment is required.

A Valuable Lesson

Soon after starting in my last plan sponsor role, I noticed that only 74% of eligible employees contributed to the 401(k). A peer and I hotly debated whether everyone should contribute. I argued, "Yes, especially since the plan has an employer match with immediate vesting." She responded, "Participants can't afford to contribute," which I countered with, "They can't afford not to." We agreed to disagree that day.

Counting participants, I found that the disconnect was even worse. Eligibility required attainment of age 21 and completion of three years of service. Less than half of our workforce was contributing—even though more than 90% expressed a favorable perception of our plan!

Many didn't voluntarily enroll once they became eligible after three years of service. Those living payday to payday weren't financially prepared to prioritize a future, distant, uncertain retirement over current needs.

That started an evolutionary journey to perennially apply automatic enrollment and escalation features and to provide "liquidity without leakage along the way to retirement."

Today, the debate with my peer over whether workers can or cannot afford to contribute—and how to facilitate those contributions—resonates beyond the 401(k) to include the HSA. I would say again that American workers can't afford to forgo participation . . . in either account.

Once considered to have only limited value for a minority of workers, HSAs can be used as part of a "health and wealth" rewards strategy. Plan sponsors can employ communication and other enrollment tactics to overcome some of the impediments that keep workers from selecting HSA-capable plans. BQ

Endnotes

1. Plan Sponsor Council of America (PSCA), "A New Look for HSAs—Retirement Savings." August 20, 2020, www.psca.org/news/PR_2020_HSAreport. See also HealthEquity, Connecting Health & Wealth, A Complicated Combination to Crack: www2.healthequity.com/health-and-wealth/ and HSA Bank, *HSA Bank Health & Wealth Index℠*: www.hsabank.com/hsabank/learning-center/hsa-bank-health-and-wealth-index.

2. L. Moore, "Tighter Municipal Budgets Shrink Retiree Health Benefits: Some city and state retirement programs swap in health stipends for medical plans or cut back benefits," *The Wall Street Journal,* November 7, 2020.

3. PSCA, Note 1, supra.

4. The Swiss Army Knife was popularized in the United States after World War II. It is a German officer's knife first produced in 1891. The Leatherman is an American brand of multi-tools, first produced in 1983, initially called the Pocket Survival Tool. It was created by Timothy S. Leatherman who was inspired to create a "Boy Scout knife with pliers." Wikipedia.

5. Contributions under the Federal Insurance Contributions Act are also known as Social Security taxes (FICA) and the hospital insurance tax (FICA-Med).

6. Internal Revenue Service (IRS), Rev. Proc. 20-45, October 26, 2020. The 2021 flexible spending account (FSA) maximum is $2,750 (www.irs.gov/pub/irs-drop/rp-20-45.pdf). See also: IRS, Rev. Proc. 20-32, May 20, 2020. The 2021 health savings account (HSA) maximums are $3,600 and $7,200 (www.irs.gov/pub/irs-drop/rp-20-32.pdf).

7. For claims purposes, once the account is opened, the HSA operates much the same as a ZEBRA—a zero-based reimbursement account (where you can contribute tax-preferred amounts *after* you know your qualifying expenses). In a February 10, 1984 IRS news release, IRS first announced that so-called ZEBRA plans were not regarded as bona fide cafeteria plans. See L. Irish, "Cafeteria Plans in Transition," (1984). William & Mary Annual Tax Conference: scholarship.law.wm.edu/tax/546. Many service providers support this unique claims process by retaining claims experience, historically referred to as *shoe boxing*.

8. S. Banerjee, "A New Way to Calculate Retirement Health Care Costs." February 2020. Median expense per person at the 50th percentile is $6,300/year—mostly Medicare and Medicare supplement or Medicare Advantage premiums (www.troweprice.com/content/dam/fai/Collections/DC%20Resources/a-new-way-to-calculate-retirement-health-care-costs/ANewWaytoCalculateHealthCareCosts.pdf). However, even middle-class retirees with modest incomes may see their Medicare premiums increase significantly should Congress decide to lower the thresholds for income-related monthly adjustment amount (IRMAA) premiums. The 2021 Part B premium equals $148.50 per person. In 2021, IRMAA Part B premiums apply to those with 2019 incomes greater than $88,000 for a single filer and $176,000 for joint returns, ranging from a minimum of $207.90 to a maximum of $504.90/person/month (www.medicare.gov/your-medicare-costs/part-b-costs#:~:text=The%20standard%20Part%20B%20premium%20amount%20in%202021%20is%20%24148.50,Monthly%20Adjustment%20Amount%20(IRMAA)). See also Centers for Medicare and Medicaid Services (CMS). 2021 Part D premium average $30.50 (www.cms.gov/newsroom/press-releases/trump-administration-announces-historically-low-medicare-advantage-premiums-and-new-payment-model). See also CMS, 2021 Part D Income-Related Monthly Premium Adjustment, November 6, 2020. CMS states that " . . . the standard base beneficiary premium . . . is $33.06 . . . The additional Part D premium ranges from $12.30/person/month to $77.10/person/month" (www.cms.gov/files/document/2021-part-d-income-related-monthly-premium-adjustment.pdf).

9. The Consolidated Appropriations Act of 2021, Pub. L. 116-260, signed by President Trump on December 27, 2020, indefinitely changed the threshold for medical expense deductibility back to 10% of adjusted gross income. However, HSA reimbursements offer significantly greater value than itemized deductions because HSA contributions are typically pretax for state income taxes, FICA and FICA-Med taxes. Itemized deductions generally don't qualify for those preferences.

10. Author's calculation.
11. *Peterson-KFF Health System Tracker,* Kaiser Family Foundation Analysis of Truven Health Analytics MarketScan Commercial Claims and Encounters Database, 2016: www.healthsystemtracker.org/brief/increases-in-cost-sharing-payments-have-far-outpaced-wage-growth/.
12. PSCA, *62nd Annual 401k and Profit-Sharing Survey,* 2019. More than 60% of plan sponsors incorporate automatic features in their plan designs.
13. PSCA note 1, supra. Only 32.2% of plan sponsors utilize a default employee contribution where the individual has enrolled in HSA-capable coverage.
14. PSCA note 1, supra. Note that 88.6% of plans provide communications/education regarding HSAs primarily or solely during annual enrollment.
15. PSCA note 1, supra. More than 80% of HSAs require a minimum capital preservation balance of $1,000 or more; only 10% allow allocations of the first dollar of savings to other investments.
16. Patient Protection and Affordable Care Act, Pub. L. 111-148, signed by President Obama March 23, 2010, added Section 2719 to the Public Health Service Act which provides that a nongrandfathered, insured group health plan must meet the nondiscrimination requirements under IRC §105(h) currently applied to self-insured plans.
17. "The Consolidated Omnibus Budget Reconciliation Act (COBRA) gives workers and their families who lose their health benefits the right to choose to continue group health benefits provided by their group health plan for limited periods of time under certain circumstances such as voluntary or involuntary job loss, reduction in the hours worked, transition between jobs, death, divorce, and other life events" (www.dol.gov/general/topic/health-plans/cobra).
18. A. Caramenico, "Survey: More Americans fear medical bills than becoming seriously ill." Fierce Health Care, April 3, 2018: www.fiercehealthcare.com/finance/survey-medical-bills-affordability-out-pocket-costs.

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