TAKING A SECOND LOOK AT HSAs

When it comes to health savings accounts (HSAs), knowledge is power. Employers and employees alike are learning that HSAs are a great way to set money aside to pay for qualified expenses, as well as a great retirement savings opportunity. Designed to help people in high-deductible health plans manage their out-of-pocket expenses, HSAs have been growing steadily in the market since their inception and are a prominent feature of today's employee benefits landscape.

HSA OVERVIEW

An HSA is a type of savings account that allows an employee to set aside money on a pre-tax basis to pay for qualified medical expenses. In order to open an HSA, an individual must first enroll in a qualified high deductible health plan (HDHP). An HDHP is thought to lower overall health care costs because the higher deductible lowers insurance premiums, which makes health coverage more affordable for employees and employers. An HDHP also forces individuals to become more conscious of their health care consumption.

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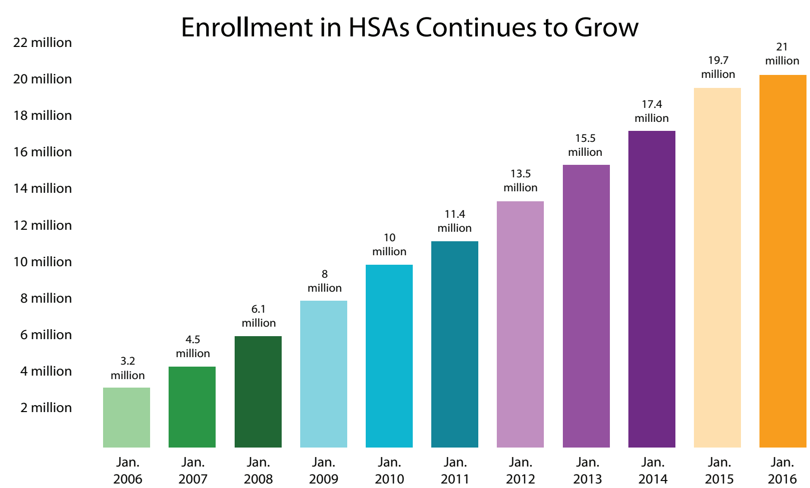
NO SIGNS OF SLOWING

HSAs have been growing in popularity since their inception — and they're only gathering more steam:



- Between 2010 and 2016, sheer enrollment in HSA-eligible plans more than doubled, growing from 10 million to 21 million enrollees.
- According to NFP's 2016 national benchmarking report, while many employers continue to offer multiple plan options, on average 46 percent of NFP clients offer an HDHP — compared to 68 percent that offer a PPO plan.
  - Of those employers offering an HDHP, 75 percent are also offering an HSA and 12 percent are offering an HRA.
- Per the Kaiser Family Foundation's 2016 survey of employers ranging in size from 2 to 5,000+ lives, the percentage of employees enrolled in an HDHP packaged with a health reimbursement account (HRA) or HSA between 2006 and 2016 has grown from 4 percent to 24 percent.

In the face of health care or tax reform, there will likely be an expansion of what HSAs can do. Currently, any plan to repeal and replace the ACA has included major changes that should greatly expand HSA usefulness and allow them to spread more freely. In fact, legislation has been introduced in both the U.S. Senate and House that's designed to give HSAs a boost, including doubling the current HSA limits (currently $6,550 for individuals and $13,100 for families).

WHAT'S SO GREAT ABOUT HSAS?

For Employees

For the employee, an HSA is essentially an individual bank or trust account that acts in conjunction with a qualified HDHP into which the employee can contribute funds on a pre-tax basis, then withdraw those funds – tax-free – when paying for qualified, medical-related expenses, including a portion of long-term care (LTC) insurance premiums.

Contributions into an HSA can help mitigate much of an employee's out-of-pocket health care costs, especially after retirement. It's predicted that the average couple that retired in 2016, at age 65, will spend $260,000* on medical expenses in retirement and, for those retiring after 2016, health care costs will rise between 4 percent and 6 percent annually. When paired with an HDHP, HSA contributions are made tax free, the balance accrues tax free and withdrawals – if used for qualified medical expenses – are made tax free.

These triple tax savings are open to anyone who meets two basic requirements:

- Have qualifying HDHP coverage (which meets certain IRS minimum deductible and maximum out-of-pocket standards)
- Don't have impermissible coverage (e.g., coverage that pays for an expense prior to the statutory minimum deductible being met — for instance, a general purpose HRA, a health flexible spending account (FSA), Medicare, health coverage through a spouse, TRICARE, etc.)

HSAs also have the potential to be just as advantageous as 401(k)s or Roth IRAs for investments, in general, thanks to their tax trifecta efficiency. The HSA is owned solely by the employee, can accept both employer and employee contributions, and is transferrable to any custodian the employee chooses regardless of employment status. The balance can grow and carry from year to year and can also be invested. In fact, if implemented early in an employee's career and, especially if contributed to by an employer, an appropriately invested HSA can potentially build a healthy nest egg that will help with health care costs in retirement.

While HSAs are certainly not a replacement for qualified, employer-sponsored retirement plans like 401(k)s and 403(b)s, they can certainly act as a force multiplier for retirement planning purposes when properly combined with a qualified retirement plan.

HSAs also shine when it comes to employee LTC insurance. These insurance policies – typically offered at the group level by employers – are designed to pay for help with self-care later in life, like in-home care, home modifications, assisted living, nursing homes and hospice. HSA funds can be used to pay a portion of an employee's LTC insurance premiums — and like most things HSA, those funds, up to the limits illustrated below, come out of the HSA tax-free.

HSA FACTS

Triple tax advantages:

1. Contributions are tax free
2. Contributions can be invested and grow tax free
3. Withdrawals aren't taxed, if used for qualified medical expenses

ATTAINED AGE DURING TAXABLE YEAR	2018 LTC INSURANCE PREMIUM MAXIMUM
40 or under	$420
41-50	$780
51-60	$1,560
61-70	$4,160
71+	$5,200

Source: IRS Revenue Procedure 2016-55 (for 2017 limits)

Finally, if an employee isn't able to pay their full LTC insurance premium from their HSA due to the limit associated with their existing age, once they advance to the next age range, they're able to recoup the shortfall from previous years. For example, if an employee purchased LTC with a premium of $2,000/year when they were age 60, they would only be able to use $1,560 from their HSA and would need to pay the remaining $440 out of pocket. The next year, at age 61, their limit goes up to $4,160. They would be able to pay the entire $2,000 premium for that year from their HSA, as well as recoup the $440 they paid out of pocket the previous year. As you can see, this can be a powerful tool!

For Employers

From the employer's perspective, a robust and effective health and wellness offering that includes an HSA helps to simultaneously attract and retain top talent and keep employees engaged in their work. While many employers offer an HDHP because it's less expensive than traditional insurance, the addition of an HSA also provides tax savings for an employer. Neither the employee nor the employer has to pay payroll taxes on HSA contributions deducted via payroll (as long as they establish a valid Section 125 plan, which can be very simple to do). An employer may also take a federal income tax deduction for any contributions it makes into its employees' HSA accounts.

According to NFP's national benchmarking report, the average employer-provided funding for an HSA is:

Employee Only	$600
Employee + Spouse	$1,000
Employee + Child(ren)	$1,000
Family	$1,200

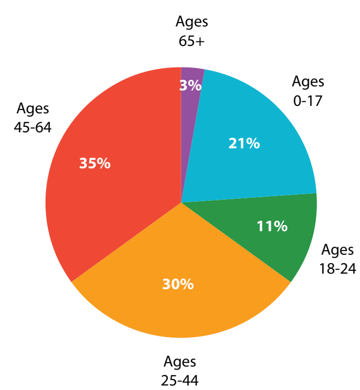
LEANING INTO GROWTH

As costs rise, employers are seeking more cost-effective alternatives that enable employees to do more with their health care dollars. HDHPs decrease the amount in premiums an employer will have to pay while increasing cost-sharing between employer and employee. As employees have a more tangible investment in their health care costs through increased cost-sharing, they begin to understand and appreciate different strategies, like HSAs, to account for additional expenses. Employees essentially trade a lower deductible for lower monthly premiums with increased cost-sharing — with the upside of building an HSA account balance in the meantime.

This means employees now have considerably more skin in the game when it comes to health care spending and, in many instances, HDHPs with HSAs are the only game in town in regard to what employers are choosing to offer as health care options. That's why it remains incredibly important for employers to stay on top of developments and trends to ensure they're delivering the best possible options to their employees, while still effectively managing their own bottom line.

HELPING EMPLOYEES CONNECT THE DOTS

HSAs have commonly been marketed as health spending accounts, rather than the health savings accounts they truly are. HSAs provide valuable coverage options for all ages. For earners of any range, but especially those middle to higher earners who are relatively healthy – even those with high out-of-pocket costs – it's worth it for an employee to do the math and calculate whether an HSA would work better for them than a low-deductible, high-premium health plan when offered a choice. If an individual or their family is relatively healthy, lowering premiums and contributing to an HSA would be more financially productive — especially if their employer is matching HSA contributions.



HSAs Provide Valuable Coverage Options for All Ages

A clearer understanding of HSAs can give employees the power to make the most of their health care options. Even well-educated and informed individuals have trouble keeping track of the latest developments in health care because they're unaware of news and trends outside of what their employers or HR departments offer.

Employer-offered HSA arrangements are often referred to as "HSA plans," but that's a bit of a misnomer. It's actually an HDHP that qualifies a covered individual for contributions to an HSA. It may seem arbitrary, but it's an important distinction to note. HSA-qualifying plans can cause some compliance confusion if limits aren't set correctly.

Similar acronyms and health spending mechanisms – HRAs and FSAs – often get confused with HSAs, but each has its own use:

- HRAs are funds set up and operated by employers so they can put money away for employee health spending. Usually combined with an HDHP, HRAs can be similar to an HSA, but employees cannot make direct contributions, and employees are reimbursed after payments for qualified medical expenses are paid out of pocket. Also, employees in general cannot take HRA balances with them when they leave the company. Funds in an HSA account stay with the employee.
- FSAs are similar to HRAs in that they're also set up by an employer and are used by employees to pay for medical expenses. FSAs are generally funded by pre-tax employee payroll deductions, making them further removed from employer responsibility and due diligence than HRAs, and are paired with lower deductible health plans rather than HDHPs. Sometimes HDHPs with HSAs can be used in conjunction with FSAs. However, in these instances FSAs must be limited in use for items like dental and vision coverage and dependent care. Also, funds in an FSA must be used before the tax year ends.

Treating an HSA as a quick-spend option severely limits an employee's ability to plan for their financial future. However, learning how to take advantage of the capabilities of an HSA and taking a proactive longer-term outlook on their current health and well-being can make all the difference.

COMMUNICATION IS KEY

An effective communication and education strategy is a critical component of a successful HSA program. Employers need to educate employees on the benefits of an HSA program and engage them in the program before, during and after annual enrollment. They need to help employees connect the dots. While an employee should be expected to exercise some due diligence in regard to their health care options and how they can make their money work better for them under an HSA, employers should work to educate their employees on all of their options and opportunities for investment, which can be as simple as jumping online and electing to invest, but the employer has to make sure the employee has the tools to do that.

Investing with an HSA is similar to investing in a 401(k) — in fact, they often use similar tools. There are tools for online enrollment as well as online compliance tools and checks for employers and providers to ensure that employers' and employees' needs and legal rules and regulations are satisfied.

Employers should note that because HSAs rely heavily on elected contributions by employees, HSAs tend to favor middle to higher earners (because lower earners have less wiggle room in their personal budgets to contribute to the accounts) and primarily benefit healthier individuals. The first part of this can cause compliance issues when employers elect to match employee HSA contributions, as contributions must operate on a fair, equal, non-discriminatory basis, not favoring higher earners (and, in some instances, the same contributions must be made for all full-time employees).

A trusted advisor will help employers select and manage the right entity, discern the appropriate funds to be planned, monitor those over time, and provide insight and guidance to employees. To truly realize a successful HSA program, you need a benefits partner and advisor who will find the best health plans possible, has a retirement division working to find the most advantageous investment opportunities, and has a thorough compliance department to make sure you're operating under best practices when delivering further incentives to your program.

Employees and employers need to be aware of the advantages of working with HSAs. It's a good idea for employers to get ahead of the curve and build a robust plan with HSA fund investments in mind. Additionally, a well-thought-out communication strategy – as well as professional employee benefits consultants who can provide assistance or guidance on that strategy – is critical to the success of an HSA program. Benefits experts will help find the right plans and products to meet employers' and employees' needs — and protect their bottom lines.

WHAT'S ON THE HORIZON

The future success and proliferation of HSAs comes down to revenue, education and communication.

Currently, for employees, there's a spending gap of about $3,500 between annual contribution limits and out-of-pocket maximums (roughly $6,500 and $10,000, respectively). ACA modification proposals or possible future tax reform working their way around Washington could increase HSA contribution limits to match or exceed the out-of-pocket max, eliminating this gap and delivering a boon to employees and employers alike. Even in the event that both health and tax reform are blocked or phased out, there's always the opportunity for piecemeal change and, since HSAs have mass appeal, there will most likely be rule changes that allow the prominence of HSAs to grow even further. Since proposed changes would simplify HSA processes and make an enticing incentive to employees out of what was to be one of the key barriers to adoption, there could be an HSA boom in the future.

Some legislators want to loosen rules relating to HSA disbursements or distributions, including eliminating the ACA rule that prohibits HSA reimbursements for over-the-counter drugs. Others want to tackle increasingly stringent rules, like allowing reimbursement for expenses incurred prior to an HSA establishment date — which usually comes after enrollment in an HDHP. This means employees would be allowed to later reimburse themselves for doctor visits or other medical care costs with money they've accrued in their HSAs after the fact, as long as they were already enrolled in an HDHP. Legislators also want to loosen rules around impermissible coverage to possibly allow someone with, for example, Medicare Part A coverage to qualify for HSA eligibility. These changes, while important and a great benefit to employees, don't truly affect the operational aspects or growth of HSAs; they just allow more wiggle room in particular real-life situations.

Looking ahead, legislators in both major political parties are in favor of increasing the annual contribution limit – doubling it, really, to about $13,000 – and that's when we'll see the next major expansion and growth in not only HSA usage, but HSA investment.

The big, expected change that could fuel HSA popularity highlights a potential shift in regard to HSA fund investment, employer matching and general fund availability — legislators want to see this increase in HSA contribution limits.

Even without major changes, HSAs are and will continue to be the investment vehicles that can deliver benefits to employers and employees as well as help businesses and individuals alike prepare for a brighter, more fruitful future. A viable part of an employee benefits strategy, HSAs are here to stay.

NFP — MARRYING HEALTH AND WEALTH

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For more information, contact your advisor.

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* "Health Care Costs for Couples in Retirement Rise to an Estimated $260,000, Fidelity Analysis Shows." Fidelity Investments. www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise

MOST PEOPLE DON'T UNDERSTAND HSAs. DO YOU?

Health savings accounts (HSAs) can be complicated and even scary. What are they? How are they used? Let us clear up common misconceptions about HSAs so you can navigate this confusing but potentially rewarding health investment space.

MISCONCEPTION #1

HSAs ARE JUST FOR THE YOUNG AND HEALTHY

Employees of all ages can take advantage of HSAs. These accounts also have the potential to be just as advantageous as 401(k)s or Roth IRAs for investments, thanks to a tax trifecta of efficiency.

If contributed to by your employer, an appropriately invested HSA can potentially build a nest egg that will help with health care costs now and in retirement.

MISCONCEPTION #2

THERE'S ONLY ONE WAY TO USE AN HSA

HSAs are versatile and powerful. They do more than just provide tax-free funds for your future health care needs. Here are three ways HSAs can help your tax situation while you invest in your future.

1. Contributions are tax free.
2. Contributions can be invested and grow tax free.
3. Withdrawals aren't taxed, if they're used for qualifying medical expenses.

MISCONCEPTION #3

HSAs ARE JUST A FAD

In reality, HSAs become more useful and convenient over time. More companies are offering these accounts as part of their package of benefits offerings. Originally designed to help employees with high-deductible health plans manage their out-of-pocket expenses, HSAs are growing in use, and are being used in more diverse ways.

Use this piece with your clients, customers and colleagues to help educate and empower them on how to make the most of HSAs.

*"Health Care Costs for Couples in Retirement Rise to an Estimated $260,000, Fidelity Analysis Shows." Fidelity Investments. www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise.