

A new perspective on health savings accounts

Learn how HSAs can help employees save for health care costs in retirement

Executive summary

The benefits landscape in the United States is rapidly changing along with the value and delivery of those benefits. With millions of baby boomers approaching retirement — and millennials now the largest demographic in the U.S. workforce¹ — the issues of which benefits are most critical and how these benefits are delivered, owned, used, transitioned and deployed are taking on new meaning. Those closer to retirement often ask whether they have enough savings and question what their health care needs will be in retirement.

Younger workers are also mindful of their prospects in retirement and have placed a premium on being in the best position possible later in their career. Eighty-eight percent of millennials agree that it's important to start saving early for retirement. Among Gen Xers, that number is 86%.²

What these seemingly different parts of our working population have in common is that both have an opportunity for greater control over one of the biggest determinants of retirement success: their financing and consumption of health care today, tomorrow and well into the future.

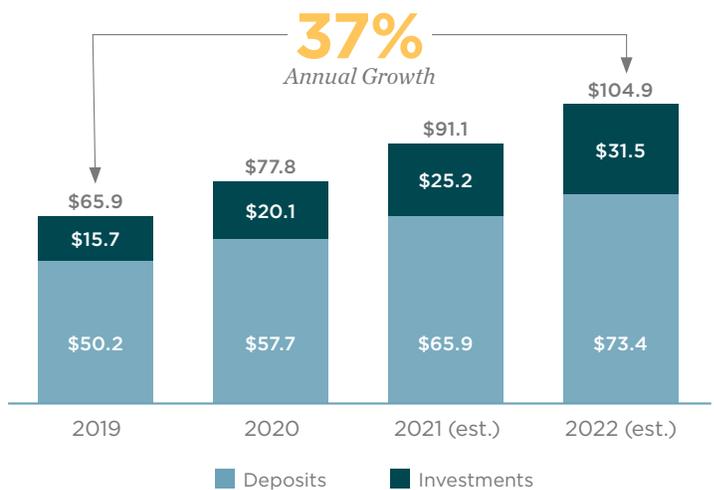
Health care costs in retirement are high, but there are



A couple retiring today could need \$325,000 for health care costs throughout their retirement.³

ways to save more effectively. Health savings accounts (HSAs) create a method for people to save on a tax-free basis for health care costs. HSAs are growing rapidly.

National HSA Assets (\$B)⁴



Given these and many other factors, we can understand the focus on health care costs in retirement and the need to save and invest for those costs today. The inclusion of an HSA, in addition to more traditional savings and investment vehicles, could be another avenue to solidify success not only in retirement but throughout the entirety of a successful career.

How HSAs function

Despite being available to the public since 2004,⁵ many people are still unfamiliar with HSAs and how they work. One reason for this is that after HSAs became available, employers were slow to adopt high-deductible health plans for their employees, in which enrollment is required before someone is able to contribute to an HSA. However, times have changed.

A health savings account is a tax-favored vehicle that works with an HSA-qualified high-deductible health insurance plan. It allows employees to contribute part of their earnings directly into an HSA on a pretax basis during their working years before they turn age 65. In turn, the account can be used for qualified medical expenses on a tax-free basis. Let's look at the various aspects of HSAs.

Key features of HSAs

HSAs create three types of possible tax benefits: pretax contributions, tax-free growth and tax-free distributions. Let's take a look at each benefit:

- Pretax contributions
 - Funded with pretax employer and employee contributions
 - Lowers current year taxes by reducing taxable income
- Tax-free growth
 - Investments held in the HSA can grow on a tax-deferred basis, much like an IRA
 - HSAs can roll over into another provider when changing jobs, and can also move to another provider at any time
- Tax-free distribution
 - Distributions for qualified health care expenses are tax free*
 - Withdrawals are penalty free (but subject to ordinary income taxes) for any expense after age 65
 - The account transfers to a spouse upon death if the spouse is the designated beneficiary

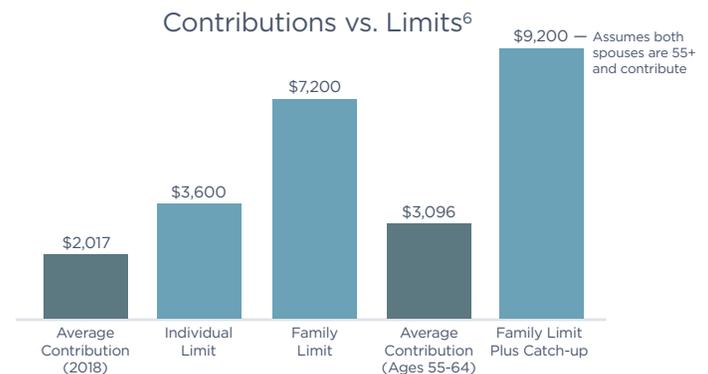
* HSAs are not taxed at a federal income tax level when used appropriately for qualified medical expenses. Also, most states, but not all, recognize HSA funds as tax-free. Please consult a tax advisor regarding your state's specific rules.

Taxation and penalties

- Withdrawals are subject to taxation plus a 20% penalty for nonqualified health care expenses
- The penalty is waived when an individual:
 - Is 65 or older
 - Is disabled
 - Has passed away during the year

IRS contribution limits (2021)

- Individual: \$3,600
- Family: \$7,200
- Catch-up: 55 years and older: \$1,000; spousal catch-up of \$1,000 as well (if placed in a separate HSA under their name)
- Contributions can be made up to April 15 of the following year, provided the account was open and qualified in the previous year (similar to IRAs)



Who can contribute

- Must participate in a high-deductible health plan
- Not covered by a spouse's or other person's non-HDHP, including a spouse's or other person's general health flexible spending account (FSA) or health reimbursement account (HRA)
- Not claimed as a dependent on another person's tax return
- Not enrolled in Medicare

How to use an HSA

- Qualified expenses include:
 - Most health care-related expenses, as described in IRS Publication 502, including:
 - Medicare premiums for Parts B, C and D (but not Medigap policies) and other health care expenses for individuals age 65 or older
 - Long-term care insurance
 - COBRA coverage while on unemployment
- What you can't use it for:
 - Unlike a 401(k), you can't take loans against your HSA

HSA's are much more than a tax-preferred checking account for current medical expenses. While HSA's are useful for current medical expenses, their flexibility and features mean they are useful for long-term savings as well. As shown in the following scenarios, an HSA can be used to accomplish a variety of objectives. These include:

- Serving as a savings and investment vehicle for health care costs in retirement
- Funding current expenses while keeping future needs in mind
- Offering immediate funding of health care and insurance expenses in a tax-efficient manner

HSA scenarios

These scenarios discuss three different situations, each with its own set of circumstances, objectives, available resources and potential outcomes. What they have in common is that each uses an HSA to achieve short- and long-term goals.

The three scenarios below are for illustrative purposes only. Every client is different and should consider the whole of their financial situation.



Scenario 1

Meet Greg and Jane – saving for retirement

- They're in their early 50s, in good health and have modest health care costs
- They've been saving for retirement and usually make the maximum 401(k) contribution
- Greg's employer recently switched to a high-deductible health insurance plan, which creates another savings opportunity
- They decide to contribute their annual family maximum of \$7,200 to their HSA (for 2021)
 - They can grow earnings more rapidly because the contributions, and the growth on those contributions, aren't taxed
 - They accelerate growth by paying most minor health care costs out of pocket
 - They allow the balance to grow and use those savings to help pay for health care costs in retirement



Scenario 2

Meet Susan – young and healthy

- She's 32 years old, single and recently promoted
- She takes great care of herself, so she has very low health care costs
- She's been contributing to her 401(k) and her HSA at work, but thought she had to use all of the HSA each year or lose those dollars
- Susan learned that she can let her HSA balance grow each year, and she could roll her HSA into her own account with any HSA vendor if she ever changes jobs
- Susan can use her HSA when she has health care expenses or let it continue to grow until she retires
 - Even if she doesn't need it for health care costs, she can access the funds without penalty once she reaches age 65⁷



Scenario 3

Meet Doug and Mary – planning for a family

- Both 25 years old, they recently married and are thinking of starting a family soon
- They're currently saving enough in their 401(k) plans to get their full employer match, and they have an emergency fund to cover a few months of expenses
- Mary received a raise of \$3,000, so they're deciding where they might save the additional income
- They're likely to face significant costs when they start a family, given that their family deductible is \$6,000
- By starting to save the \$3,000 in their HSA for two or three years, they could potentially have enough to cover their deductibles
 - Because the savings are made and spent on a pretax basis, they could save more this way than trying to accumulate these savings in a traditional after-tax vehicle

The impact of an HSA in conjunction with a qualifying high-deductible health plan and other savings vehicles can play a key role in how we use our health care dollars. An HSA can impact the health care financing and delivery methods for each situation and positively impact people in the immediate, short and long term as well as at retirement and beyond.

Advantages

Employers

Employers are seeking top talent across all skill levels and realize that a robust benefits package, most often led by strong health care benefits, can be a key factor in attracting and retaining talent.

Another consequence of an employer offering the high-deductible health plan/HSA combination is its potential to:

- Allow older employees the opportunity to retire early if assets are available to help cover their medical expenses prior to Medicare eligibility
- Help lower the cost of providing health insurance to its employees
- Free up company assets for other benefits or human resources expenses

Financial professionals



70% of older adults

with a financial professional say that one of their top fears in retirement is their health care costs going out of control **and yet only 1 in 3 older adults plan on discussing health care costs during retirement with a financial professional or consultant.**⁸

Health care is often the largest and most misunderstood aspect of retirement income planning. The idea that a “health” account of any kind would be a talking point for a private wealth or corporate retirement financial professional may have been foreign in years past, but thanks to the HSA, not anymore.

Expand your expertise

- The inclusion of HSAs in a financial professional’s practice is a timely differentiator that demonstrates broad retirement expertise and investment acumen
- By articulating the investment opportunities in many HSAs, financial professionals can increase their value in the benefit broker and CPA referral network
- HSAs have many advanced planning implications for efficient accumulation and distribution strategies, legacy planning, long-term care financing and tax-savings strategies



Contact the Retirement Institute Planning Team at 1-877-245-0763 to learn how HSAs can help employees save for retirement.

¹ "Millennials are the largest generation in the U.S. labor force," Richard Fry, pewresearch.org/fact-tank/2018/04/11/millennials-largest-generation-us-labor-force (April 11, 2018).

² "5 retirement savings myths about Gen X and millennials," BenefitsPRO magazine, benefitspro.com/2016/01/27/5-retirement-savings-myths-about-gen-x-and-millenn?sreturn=1455714220&page=3 (Jan. 27, 2016).

³ "A Bit of Good News During the Pandemic: Savings Medicare Beneficiaries Need for Health Expenses Decrease in 2020," Paul Fronstin and Jack VanDerhei, EBRI (May 28, 2020).

⁴ 2020 Midyear Devenir HSA Market Survey (Sept. 1, 2020).

⁵ The Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

⁶ "Health Savings Account Balances, Contributions, Distributions, and Other Vital Statistics, 2018: Statistics From the EBRI HSA Database" (Dec. 5, 2019).

⁷ There is a 20% penalty if the HSA assets aren't used for health care expenses prior to age 65. IRS Publication 969 (2019).

⁸ "2019 Nationwide Health Care Consumer Survey," conducted by The Harris Poll on behalf of the Nationwide Retirement Institute (2019). The fifth annual survey was conducted by The Harris Poll from March 25 to April 10, 2019. It included 1,462 older adults in the United States who are age 50 or older and have \$50,000 or more in investable assets. Respondents fell into three main categories: Future Retirees who aren't currently retired, Recent Retirees who retired less than 10 years ago and Retired 10+ who have been retired for 10 or more years.

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