DC Perspectives

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Are HSAs the Next Retirement Account?

A Health Savings Account (HSA) is a type of savings account that allows an individual to set aside pre-tax money to pay for qualified medical expenses, such as doctors, dentists, vision care, and prescriptions. Individuals are eligible to contribute to an HSA if they are covered under a High Deductible Health Plan (HDHP), most often offered by an employer.

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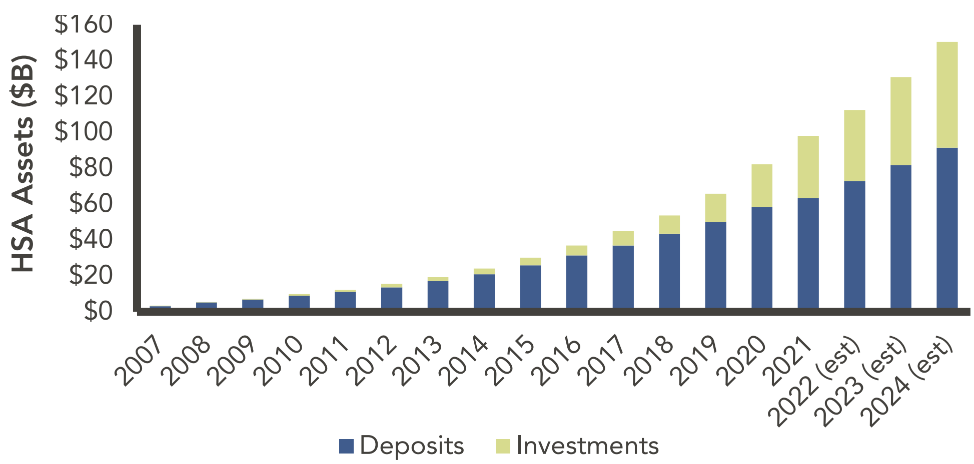
As shown in Exhibit 1 below, assets within HSAs grew to an estimated $98 billion last year,[1] with continued growth expected in the years ahead. Within HSA accounts, investment assets rose to an estimated $34 billion at the end of 2021. While HSA assets have grown at an annualized rate of 15% over the last five years, investment assets within HSA accounts have grown at a rate of 44%, to 35% of total HSA assets as of 2021 from less than 10% 10 years ago.

Exhibit 1: Within the growing HSA market, investments are growing as a percentage of assets, projected to reach nearly 40% of HSA funds by 2024



Source: Devenir Research as of December 31, 2021

[1] Devenir Research, 2021 Year-End HSA Market Statistics & Trends Executive Summary

HOW DOES AN HSA WORK?

In addition to the impact of market gains, a driving force behind this asset growth has been the triple tax benefits that HSA plans provide. Specifically, HSA participants can:

- Contribute assets to their plans on a tax-free basis,
- Grow assets within their plans on a tax-free basis, and
- Withdraw assets from their plans for medical expenses on a tax-free basis

Unlike Flexible Spending Accounts (FSAs), where assets must be used for medical expenses within the plan year — often referred to as "use it or lose it" — HSA plan assets are allowed to remain in the account and be carried over year to year. HSA participants can use their accounts either as a source of funds for current medical expenses or as a savings vehicle in preparation for payment of longer-term qualified medical expenses in retirement.

In a standard HSA plan, participant assets are invested in a cash account. Depending on the provider, once a participant reaches a minimum investment threshold — typically a minimum asset balance of $1,000–$2,000 — the individual becomes eligible to allocate to investment options, which may include equity and fixed income mutual funds.

Unlike other retirement vehicles such as 401(k)s or Individual Retirement Accounts (IRAs), HSA plans do not have a required minimum distribution (RMD). The benefits of not having an RMD allow participants to leave assets within the account for a longer period of time and, if invested, compound gains in the market. After an individual reaches age 65, in addition to tax-free withdrawals for medical expenses, participants are allowed to withdraw their HSA funds for non-medical expenses without penalty, though non-medical withdrawals will be taxed as ordinary income. If HSA funds are withdrawn for non-medical expenses before the age of 65, the IRS will require payment of income tax plus a 20% penalty on assets withdrawn.

CONTRIBUTIONS

The IRS limits the amount that individuals or families can contribute to HSA and 401(k) plans in a calendar year. Most recently, the annual inflation-adjusted limits were announced for 2023: HSA contribution limits increased by $200–450 and 401(k) contribution limits increased by $2,000.

HSA Contribution Limits

	2023	2022	2021	2020	2019
Individual Coverage	$3,850	$3,650	$3,600	$3,550	$3,500
Family Coverage	$7,750	$7,300	$7,200	$7,100	$7,000
Catch-up (age 55+)	$1,000	$1,000	$1,000	$1,000	$1,000

401(k) Contribution Limits

	2023	2022	2021	2020	2019
Elective Deferrals	$22,500	$20,500	$19,500	$19,500	$19,000
Catch-up (age 50+)	$7,500	$6,500	$6,500	$6,500	$6,000

Source: Internal Revenue Service (IRS) as of October 21, 2022

CONSOLIDATING RETIREMENT ASSETS

A recent trend in defined contribution (DC) is the technological enhancements of retirement plan recordkeepers and their ability to offer HSA plan integration with certain plan providers or offer their own proprietary solution. This provides participants with single sign-on capabilities and the ability to view their accounts on a single screen, creating a holistic view of their retirement assets. Moreover, employers that offer both a DC plan and HSA plan are beginning to offer the same investment lineup under both plans, providing consistency to participants.

Exhibit 3: Holistic view of a participant's retirement assets

Exhibit 4 below shows a general DC plan investment lineup for a 401(k) plan offering. Investments include the Tier 1 Option — Target Date Funds — for the "do it for me" investors, as well as Tier 2 and 3 Options, which include a mix of equity and fixed income funds for the "do it myself" investors. To help participants avoid confusion, plans are beginning to mirror the same investment lineup for both their DC plan and HSA plan, with the intent to improve the experience and outcome for employees.

Exhibit 4: HSAs have the ability to offer similar investments to a DC plan

	DC Plan	HSA Plan	Same Funds?
Tier 1: Lifecycle / Dynamic Asset Allocation Funds			
Target Date Funds	✓	✓	Yes
Tier 2: Core Options			
U.S. Large-Cap	✓	✓	Yes
U.S. Mid-Cap	✓	✓	Yes
U.S. Small-Cap	✓	✓	Yes
Non-U.S.	✓	✓	Yes
Bonds	✓	✓	Yes
Cash Preservation	✓	✓	Yes
Tier 3: Specialty Options			
Diversified Inflation Protection	✓	✓	Yes

With a number of benefits to participants, HSA plans can serve as a powerful tool for individuals planning for retirement. Marquette will continue to monitor the evolving dynamics and regulations affecting retirement account assets and provide updates to clients accordingly.

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