

Retire Right

Next Step Retirement & Insurance Services

Hidden Gem: HSAs in Retirement



When saving for retirement, you're probably aware of the benefits of using tax-preferred accounts such as 401(k)s and IRAs. But you may not be aware of another type of tax-preferred account that may prove very useful,

not only during your working years but also in retirement: the health savings account (HSA).

HSA in a nutshell

An HSA is a tax-advantaged account that's paired with a high-deductible health plan (HDHP). You can't establish or contribute to an HSA unless you are enrolled in an HDHP. An HDHP provides "catastrophic" health coverage that pays benefits only after you've satisfied a high annual deductible. However, you can use funds from your HSA to pay for health expenses not covered by the HDHP.

Contributions to an HSA are generally either tax deductible if you contribute them directly, or excluded from income if made by your employer. HSAs typically offer several savings and investment options. Your employer will likely indicate which funds or investment options are available if you get your HSA through work. All investments are subject to market fluctuation, risk, and loss of principal. When sold, investments may be worth more or less than their original cost.

Withdrawals from the HSA for qualified medical expenses are free of federal income tax. However, money you take out of your HSA for nonqualified expenses is subject to ordinary income taxes plus a 20% penalty, unless an exception applies.

Benefits of an HSA

An HSA can be a powerful savings tool. First, it may be the only type of account that allows for federal income tax-deductible or pre-tax contributions coupled with tax-free withdrawals. Depending upon the state, HSA contributions and earnings could be subject to state taxes. In addition, because there's no "use it or lose it" provision, funds roll over from year to year. And the account is yours, so you can keep it even if you change employers or lose your job.

HSA as a retirement tool

During your working years, if your health expenses are relatively low, you may be able to build up a significant balance in your HSA over time. You can even let your money grow until retirement, when your health expenses are likely to be greater.

In retirement, medical costs may prove to be one of your biggest expenses. Although you can't contribute to an HSA once you enroll in Medicare (it's not considered an HDHP), an HSA can help you pay for qualified medical expenses, allowing you to preserve your retirement accounts for other expenses (e.g., housing, food, entertainment, etc.). And an HSA may provide other benefits as well.

- An HSA can be used to pay for unreimbursed medical costs on a tax-free basis, including Medicare premiums (although not Medigap premiums) and long-term care insurance premiums, up to certain limits.
- You can repay yourself from your HSA for qualified medical expenses you incurred in prior years, as long as the expense was incurred after you established your HSA, you weren't reimbursed from another source, and you didn't claim the medical expense as an itemized deduction.
- And once you reach age 65, withdrawals for nonqualified expenses won't be subject to the 20% penalty. However, the withdrawal will be taxed as ordinary income, similar to a distribution from a 401(k) or traditional IRA.
- At your death, if your surviving spouse is the designated beneficiary of your HSA, it will be treated as your spouse's HSA.

HSAs aren't for everyone. If you have relatively high health expenses, especially within the first year or two of opening your account, you could deplete your HSA or even face a shortfall. In any case, be sure to review the features of your health insurance policy carefully. The cost and availability of an individual health insurance policy can depend on factors such as age, health, and the type and amount of insurance.

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Cartoon: Happy Fourth of July!



Retirement & Insurance

How Does Your Employer's Retirement Plan Compare?



To compare your plan's offerings and features with those described in this article, review your plan materials or ask your Human Resources Department for its Summary Plan Description.

Diversification is a strategy that helps manage investment risk; it does not guarantee a profit or protect against investment loss.

Mutual funds and target-date funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from the fund company or your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

Each year, the Plan Sponsor Council of America (PSCA) surveys employers to gauge trends in retirement plan features and participation. Results are used by employers and plan participants to benchmark their plans against overall averages. How does your plan compare to the most recent survey results, released at the end of 2018?¹

Participation and savings rates

Plan participation (that is, the percentage of participants contributing to the plan) was on the rise, increasing from 77% in 2010 to 85% in 2017. Employees in the financial, insurance and real estate, manufacturing, and technology and telecommunications sectors were most likely to contribute (more than 85% of eligible employees), while those in the transportation, utility, and energy sectors (75.6%) and wholesale distribution and retail trade sectors (59.7%) were least likely.

The average amount participants contributed to their plans rose from 6.2% of salary in 2010 to 7.1% in 2017. Participants in the health-care sector contributed the most (8.7%), while those in durable goods manufacturing contributed the least (6.3%).

Roth option on the rise

Roth contributions are growing in popularity among 401(k) plans. Unlike traditional pre-tax contributions that are deducted from a paycheck before income taxes are assessed, Roth contributions are made in after-tax dollars. The primary benefit is that "qualified" withdrawals from a Roth account are tax-free. A withdrawal is qualified if the account has been held for at least five years and it has been made after the participant reaches age 59½, dies, or becomes disabled.

The percentage of plans allowing participants to make Roth contributions rose from 45.5% in 2010 to nearly 70% in 2017. Almost 20% of eligible employees made Roth contributions.

Company contributions

Nearly all employers surveyed contributed to their employees' plans through matching contributions, non-matching contributions, or a combination of both. And it appears that employers have become more generous over time, as the average company contribution rose from 3.5% in 2010 to 5.1% in 2017. Moreover, many employers impose a vesting schedule on their contributions through which plan participants earn the right to keep the company contributions over time. In 2017, less than 40% of companies allowed their employees to become immediately vested in the company contributions.

Investment options

When it comes to your retirement plan, how many options would you prefer on your investment menu? Too few funds could limit the opportunity for an appropriate level of diversification, while too many funds might cause an overwhelming decision-making process. So what's the "right" number?

According to an article in *InvestmentNews*, an appropriate number of investment options (typically mutual funds) is 15 to 20.² And according to the PSCA, employers seem to be following this guideline, as the average number of funds offered among survey respondents was 20.

The most common types of funds offered were indexed domestic equity funds (84.6% of plans), followed by actively managed domestic equity funds (83.6%), actively managed domestic bond funds (78.9%), and actively managed international/global equity funds (77.9%). Target-date funds — those that offer a diversified mix of different types of investments based on a participant's target retirement date — were offered in 70.6% of plans.

Overall, the two most popular types of funds, based on percentage of assets invested, were target-date funds and actively managed domestic equity funds.³

¹ PSCA, 61st Annual Survey

² *InvestmentNews*, February 16, 2018

³ The return and principal value of mutual funds fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost. A bond fund is a mutual fund that comprises mostly bonds and other debt instruments. The mix of bonds depends on each fund's focus and stated objectives. Bond funds are subject to the same inflation, interest rate, and credit risks as their underlying bonds. As interest rates rise, bond prices typically fall, which can adversely affect a bond fund's performance. Investing internationally carries additional risks such as differences in financial reporting, currency exchange risk, as well as economic and political risk unique to the specific country; this may result in greater share price volatility. The target date is the approximate date when an investor plans to withdraw money. The mix of investments in the target-date fund becomes more conservative as the date grows closer. The further away the date, the greater the risks the fund usually takes. The principal value is not guaranteed at any time, including on or after the target date. There is no guarantee that a target-date fund will meet its stated objectives. It is important to note that no two target-date funds with the same target date are alike. Typically, they won't have the same asset allocation, investment holdings, turnover rate, or glide path.

Quiz: How Much Have You Thought About Health and Health-Care Costs in Retirement?



According to the 2018 Senior Report from America's Health Rankings, social isolation is associated with increased mortality, poor health status, and greater use of health-care resources. The risk of social isolation for seniors is highest in Mississippi and Louisiana and lowest in Utah and New Hampshire.

When planning for retirement, it's important to consider a wide variety of factors. One of the most important is health and its associated costs. Thinking about your future health and the rising cost of health care can help you better plan for retirement in terms of both your finances and overall well-being. This quiz can help you assess your current knowledge of health and health-care costs in retirement.

Questions

1. Health-care costs typically rise faster than the rate of inflation.

True.

False.

2. You could need more than \$500,000 just to cover health-care costs in retirement.

True.

False.

3. Medicare covers the costs of long-term care, as well as most other medical costs.

True.

False.

4. The southern, warmer states are generally the healthiest places for seniors to live.

True.

False.

5. If you're concerned about health-care costs in retirement, you can just delay your retirement in order to maintain your employer-sponsored health benefits.

True.

False.

Answers

1. True. The average inflation rate from 2010 to 2017 was less than 2%, while the average spending on prescriptions, doctors, and hospitals grew between 4% and 5%. From 1970 to 2017, annual per-capita out-of-pocket spending on health care grew from about \$600 to approximately \$1,100 (in 2017 dollars).¹

2. True. In 2017, America's Health Rankings projected that a 45-year-old couple retiring in 20 years could need about \$600,000 to cover their health-care costs, excluding the cost of long-term care. The same report projected that about 70% of those age 65 and older will need some form of long-term care services. And according to the Department of Health and Human Services, the average cost of a one-year stay in a nursing home (semi-private room) was \$82,000 in 2016.²

3. False. Original Medicare Parts A and B help cover inpatient hospital care, physicians' visits, preventive care, certain laboratory and rehabilitative services such as physical therapy, and skilled nursing care and home health care that are not long term. Medicare Part D helps cover the cost of prescriptions (within certain guidelines and limits). Medicare does not cover several other costs, including long-term care, dental care, eye exams related to eye glasses, and hearing aids. Seniors may need to purchase additional insurance to cover these and other services not covered by Medicare.³

4. False. Interestingly, America's Health Rankings found that the five healthiest states for seniors were (1) Utah, (2) Hawaii, (3) New Hampshire, (4) Minnesota, and (5) Colorado.⁴

5. Maybe true, maybe false. Many people believe they will work well into their traditional retirement years, both to accumulate as large a nest egg as possible and to take advantage of employer-sponsored health benefits (if offered beyond Medicare age). While this is an admirable goal, you may not be able to control when you actually retire. In a 2018 retirement survey, nearly 70% of workers said they planned to work beyond age 65; 31% said they would retire at age 70 or older. But the reality is that nearly 70% of current retirees retired before age 65. Many of those individuals retired earlier than planned due to a health problem, disability, or other unforeseen hardship.⁵

The bottom line is that while it's hard, if not impossible, to predict your future health needs and health-care costs, it's important to work these considerations into your overall retirement planning strategies. Take steps now to keep yourself healthy — eat right, exercise, get enough sleep, and manage stress. And be sure to account for health-care expenses in your savings and investment strategies.

¹ Consumer Price Index, Bureau of Labor Statistics, 2018, and Peterson-Kaiser Health System Tracker, 2018

² Preparing for Health Care Costs in Retirement, America's Health Rankings, 2017, and LongTermCare.gov, 2018

³ Medicare.gov

⁴ Senior Report, America's Health Rankings, 2018

⁵ 2018 Retirement Confidence Survey, Employee Benefit Research Institute



As a business owner, what should I know before adding a financial wellness program?

Financial wellness programs are gaining traction among employee benefit offerings, and for good reason: In an International Foundation of Employee Benefit Plans (IFEBC) survey, 96% of employers said employees' personal financial issues had an impact on their overall job performance. If you're thinking of adding a financial wellness program to your benefits lineup, consider the following points.

Understand what "financial wellness" is. In 2014, the Consumer Financial Protection Bureau (CFPB) conducted a study to help measure the effectiveness of financial literacy programs. As part of their initial work, researchers sought to define financial well-being. After conducting nearly 60 hours of open-ended interviews with consumers, study authors concluded that financial well-being is achieved when people (1) are able to control day-to-day and month-to-month finances, (2) have the capacity to absorb a financial shock, (3) are on track to meet their financial goals, and (4) have the financial freedom to make choices that allow them to enjoy life.

Assess employee concerns. The IFEBC also found that 40% of employers report an increased demand for financial education. Toward this end, Prosperity Now, a nonprofit organization dedicated to helping all Americans prosper, recommends that employers conduct a needs assessment to determine the most pressing financial concerns of their workforces. While the IFEBC said the top three most popular financial topics covered through such plans are retirement benefits, pre-retirement planning, and budgeting, a workforce composed of relatively young employees may be more concerned with repaying student loans and saving for a down payment on a first home. To position your financial wellness program for success, be sure it's designed to tackle challenges that are specific to your primary employee demographic.

Determine how you will measure your success. Prosperity Now recommends considering the following metrics: participation rates; financial well-being as measured by the [CFPB's Financial Well-Being Scale](#); employee retention, satisfaction with employer, morale, and stress levels; and company cost savings.

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