Is an HSA Missing From Your Retirement Savings Strategy?

Maryalene LaPonsie | Nov. 30, 2015

A health savings account is only for medical expenses right? Not according to some experts.

HSAs are another way for you to beef up your retirement savings.

Ryan Tiernan is something of a health savings account evangelist. The founder and owner of Access Point HSA, a health savings account administrator, says many people overlook the potential of an HSA to pad their retirement nest egg.

"The H is for health but don't be fooled," he says. "A lot of people don't realize they can invest [HSA money]." As a result, their health savings deposits may be languishing in an account where they earn little to no interest.

Tiernan advocates a different approach to HSAs – one that has workers thinking of their account as not simply a way to save money on medical expenses but as another option to beef up retirement savings.

Tax Savings Times Three

HSAs were created in 2003 to complement high-deductible health insurance plans. High deductible plans typically require that policyholders spend thousands before their insurance coverage kicks in. With an HSA, people can get a tax-break on those out-of-pocket costs.

“Wouldn’t it be great to have a triple tax-free bucket?” Tiernan asks.

That’s exactly what an HSA offers. Money deposited into the account is tax deductible, up to certain limits. It then grows tax-free, and when withdrawn for qualified medical expenses, it is tax-exempt.

Even better, Tiernan says, there are no income limits on who can contribute to an HSA and no required distributions in retirement, as is the case with traditional IRAs. However, annual contributions to HSAs are capped in 2016 at $3,350 for individuals and $6,750 for those with family coverage. What’s more, only those with qualified high-deductible plans can contribute to an HSA.

Accounts that Do Double Duty

Craig Ferrantino, president of Craig James Financial Services on Long Island, New York, is another fan of HSAs.

“The biggest fear I have as an advisor is that people haven’t saved enough for health care,” he says. An HSA puts the focus on medical savings, and yet, it doesn’t lock money in for that purpose.

Money put into these accounts may be intended for health care, but account holders can pull out cash and use it for a vacation, home renovations or anything they’d like. The only catch is money withdrawn for nonmedical expenses before age 65 gets hit with a 20 percent tax penalty in addition to income tax. However, after age 65, you can pull money out for any purpose and only pay income tax. In that way, the HSA operates much like a traditional IRA, which has a penalty on withdrawing funds before age 59 ½.

“What does it hurt to put $5,000 into an HSA?” Ferrantino asks. “If you don’t use it, it’s like another nest egg.”

Diversification: Not Just for IRAs

Not only can money from an HSA be withdrawn like a traditional IRA after age 65, it can also be invested in much the same way.

“I have a percentage [of my HSA money] in a fixed account and then the excess goes into an investment account,” says John Gajkowski, a certified financial planner and co-founder of Money Managers Financial Group in Oak Brook, Illinois. “In my particular case, the custodian [of my HSA] has a selection of 30 to 40 mutual funds you can use.”

In other words, just as money can be spread across multiple IRA accounts, people can open and maintain multiple HSAs. Using multiple accounts, as Gajkowski does, allows money to be diversified in funds that offer varying levels of stability and growth. Fixed accounts offer stable, if minimal, returns on deposits. Meanwhile, investment accounts come with more volatility but also the promise of more growth.

Workers Not Aware of the Possibilities

With the tax benefits and investment possibilities presented by HSAs, the question may be why more workers don’t make use of these accounts. Although the numbers have been steadily climbing, only a quarter of workers have HSA-high deductible health plans, according to a Kaiser Family Foundation report.

The reason more people don’t use HSAs could be two-fold. Some households may have chronic conditions or high medical bills that make high-deductible plans impractical.

But for others, “it boils down to a lack of education,” says Melissa Spickler, a managing director with Merrill Lynch in Bloomfield Hills, Michigan. “People say, ‘I don’t really understand what it does for me so I’m not going to do it.’”

Instead of focusing on the long-term savings potential of an HSA, many workers think of it only as a way to pay off their current medical bills tax-free. “It needs to be sold better,” Ferrantino says of the way HSAs are often presented to the public.

Spickler says other workers may simply feel like they already spend too much on health care expenses and are hesitant to put more of their money toward that budget category. “It’s dependent upon us as advisors to educate clients that it’s one more way to save money for later on down the road,” she says.

As for Tiernan, he’s hopeful HSAs will eventually catch on as not only a way to save for medical expenses but as another avenue to save for retirement. It’s something he’s already seeing. “People are starting to catch on and are kicking the tires.”