BBVA Compass Consulting & Benefits

Health Savings Accounts Can Build Retirement Wealth

When preparing retirement funds to sufficiently carry an employee through their retirement years, it's crucial for the employee to think about all the ways that they can potentially maximize their workplace benefits. A great example can be found by looking at how a health savings account or HSA could also function as a retirement account. In certain instances, such as with employees that aren't made to spend down HSA contributions each year, HSA's can function in just such a manner.

Let's say that there's a 40-year-old worker that's very concerned that he isn't saving enough to last him through his retirement years. He seeks the guidance of a professional financial advisor to address his concerns. The advisor runs a retirement projection based on the worker's 401 (k) contributions. Unfortunately, the worker discovers that he needs to save around five percent more than his current six percent salary deferral in order for him to have his retirement where it should be.

At this point, the advisor and the worker start to talk about where the extra retirement funds could possibly come from. One option would be to increase his 401 (k) contribution. However, the worker brings up how he's maxing out his contributions to his HSA, around $3,000 dollars per year. He goes on to say that he's considering lowering his deferral during the next open enrollment period. And, here is where the worker discovers that he can build retirement funds with his HSA. Since his deductible is only $1,800, the excess funds can be counted toward his needed retirement savings.

Of course, the above is just one scenario of using an HSA. There's actually several reasons why it could be beneficial for an employee to use a large HSA balance as part of their retirement.

- Most people naturally have more medical expenses with age. A study by Fidelity may add a little perspective, as it estimates that around $250,000 in non-Medicaid covered health expenses will occur during the retirement years of a typical 65-year-old retired couple. Wouldn't it be nice if these expenses could be paid for tax-free? Well, they can be with an HSA. HSA funds can be used without taxation for various qualified medical expenses - from long-term care insurance premiums to remodeling a home to accommodate a wheelchair or other assistive living device.
- For individuals that are fortunate enough not to have high medical expenses throughout their years at work, an HSA can provide some financial flexibility. Although funds are subject to taxation when not used for medical-related purposes, those at least 65-year-old can withdraw the funds for any reason they see fit.
- A Roth 401 (k) has tax-free withdrawing, but is funded with post-tax dollars. A traditional pretax 401 (k) features tax breaks only up until retirement. The benefits of an HSA are unique in that funds contributed to it are in the form of pretax dollars and remain tax-free on withdrawal for medical purposes.

The Growing Nest Egg

Financial institutions that manage HSA accounts typically allow investment of HSA funds (in excess of the an employees annual deductible) into mutual funds. In other words, if the HSA has an annual deductible of $2,000 and the employee contributes $3,000 dollars to the HSA, then the employee could invest the annual unused $1,000. After thirty years at 7% annual interest, the employee would have grown a retirement nest egg of about $100,000.

Imagine how elated the worker in the above scenario might be to find out that his employer had not only given him the flexibility of using his HSA for his current and future medical expenses, but also a means to supplement or pad his retirement nest egg?

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