Beyond Contributions and Saving — The Importance of HSA Investing

Education is key in helping employees see the HSA as an investment vehicle.

By Austin Rosenthal for PSCA's HSA Committee

Health Savings Accounts (HSAs) allow Americans to save for current and future medical expenses on a tax-advantaged basis. What should plan sponsors consider when designing programs that give employees the opportunity to invest the money in their HSA? This article will examine some of the best practices in HSA plan design concerning investment and education.

Current Landscape

PSCA's *2019 HSA Survey*, which includes responses from 189 employers that offered an HSA-qualifying health plan in 2018, found that more than 85 percent of employees with access to an HSA contributed to their accounts. Nearly two-thirds of respondents were unsure of how participants used those accounts, but among the employers who tracked usage, approximately 28 percent of their employees spent their entire HSA balance. What about those employees who did not spend their entire balance? Are they investing their unspent contributions, and if so, are they investing appropriately?

Goals-Based Investing Principles

When investing with a goal in mind, it's important to clearly identify the goal. Is it a readily available pot of money, for instance, or is it an income stream? Is it a particular need that must be accounted for? One example would be planning for future medical expenses during one's working years or in retirement.

Estimates of required savings to fund medical expenses in retirement range from $150,000 to $400,000, according to the Employee Benefit Research Institute.[1] Many Americans may not have considered accounting for this expense as part of their retirement planning, which is one reason they may benefit from using HSAs as an investment vehicle.

Once plan sponsors educate employees about potential health care costs in retirement, attention can turn to how plan participants can invest, given the options available and the design of the HSA plan offered by the employer.

Review of HSA Programs and Investment Options

HSA providers have been working with employers to provide more access to well-diversified, low-cost, high-quality investment options. Choosing which investment funds to offer in an HSA should take into account participants' ultimate goals. However, finding the right balance between a spending-focused HSA that features checking and debit card options and an investment-focused HSA depends on plan demographics. Do employees tend to have substantial health care needs in the current period? Are they able to fund their current health care expenses out of pocket and store the HSA assets for investment instead? A company's education plan can play an important role in clarifying these options and may have behavioral implications for how participants view their HSA. If the education focuses primarily on spending the account balance in the current period, employees may be more likely to spend it. If the education focuses on the benefits of the favorable tax treatment offered by HSAs and the opportunity for investment growth, employees may be more likely to invest their balances.

As of mid-year 2019, almost 22 percent of the $61.7 billion in HSA assets was invested, with an average investment balance of $12,000 per account.[2]

The good news is that participants, especially those eligible for catch-up contributions, can put away meaningful amounts of money in their HSAs. With an investing horizon of 10 or more years until retirement, employees 55 or older can begin to build significant savings for future medical expenses by making a maximum family HSA contribution of $8,000 per year for the 2019 tax-year and then continuing that strategy in the years ahead.

Considerations When Evaluating Investment-focused HSAs

According to Morningstar's recent research report "2019 Health Savings Account Landscape,"[3] the following best practices should be considered:

1. **Menu Design:** Offer investment strategies in all core asset classes while limiting overlap among options.
2. **Quality of Investments:** Provide strong investment strategies that earn Morningstar medals.
3. **Price:** Charge low fees for both active and passive strategies.
4. **Investment Threshold:** Don't require investors to keep money in the checking account before investing, which creates an opportunity cost.

Figure A shows a typical layout of an investment menu and Morningstar's recommended asset classes for an HSA lineup. Notice that it looks similar to many lineups used in 401(k) plans.

Insights from the PSCA 2019 HSA Survey

The survey yielded some insightful findings that may be of value to plan sponsors.

Some highlights from the survey and the insights we've drawn from the findings include:

- **Popularity of offering an investment option:** 86 percent of all plans offered investment options as part of their HSAs.

  Insight: *Plan sponsors are doing a good job of offering investments in their plans; therefore, employees generally do have the ability to invest their balances to fund future medical expenses.*

- **Investment selection:** In 91 percent of those cases, the HSA provider selected the fund lineup. Plan sponsors chose the funds about 4 percent of the time, with about 5 percent being other.

Figure A: Morningstar's Typical HSA Investment Menu Layout

Allocation			
Target-Date Series Target-Risk Series Other Allocation		At least one	
Equity	Value	Blend	Growth
US Large-Cap		At least one	
US Mid-Cap US Small-Cap		At least one	
International Developed World Stock		At least one	
Emerging Markets		Optional	
Specialty Equity		Optional	
	Cash Equivalent/Short-term	Core	Specialty Fixed-Income
Fixed Income	At least one	At least one	Optional
Alternatives/Other	Optional		

Source: Morningstar, Inc.

Insight: *Plan sponsors may not want the obligation of selecting the funds in the HSA plan but should understand the fund lineup that is being offered by the HSA provider. Some questions to consider: Does the construction of this lineup make sense, i.e., does it offer a broad range of investment strategies while limiting fund overlap? Do the options include target date funds or balanced funds? Are they well-diversified and attractively-priced investment strategies? Is there any flexibility to the provider's "standard lineup"?*

- **Minimum account balances:** In 43 percent of the plans offering HSA investments, a minimum account balance of more than $1,000 was required before participants could invest their assets; 33 percent of plans required a minimum of a $1,000, and only 15 percent didn't have a minimum before participants could invest.

  Insight: *From a behavioral perspective, the lower the required minimum, the more likely participants will be to invest.*

- **Investment lineup confusion:** Only 3 percent of plans had HSA investment lineups that matched their 401(k) plan lineups.

  Insight: *Plan sponsors may wish to try to match these lineups as closely as possible because participants may be more familiar with the funds in their 401(k).*

Case Study: Dimensional Fund Advisors HSA Plan

Here at Dimensional, before we began working with our current HSA plan provider HealthSavings Administrators in 2011, our previous HSA provider required employees to maintain a minimum $1,000 cash balance prior to investing their savings. At that time, only 14 percent of our employees with HSAs had sufficient account balances to be able to invest, and approximately 5 percent of qualifying employees with HSAs chose to invest. Dimensional was concerned that our employees were not acquainted with the benefits of long-term investing through an HSA.

Our firm wanted employees to learn more about the advantages of saving for retirement health care costs, so we chose to reframe HSAs as a component of a comprehensive retirement investment strategy instead of being simply a tool to pay for current medical expenses.

To make that happen, Dimensional wanted an HSA that did not require a minimum cash balance as a prerequisite to investing and a provider that could offer additional targeted education.

Dimensional and HealthSavings designed a two-step program to eliminate HSA investment barriers and provide employees with ongoing education about the power of HSA saving and investing:

Step 1: Remove Investment Barriers

HealthSavings offers first-dollar investing to clients, which made the firm a fit for Dimensional's objectives. At first, Dimensional paired the HealthSavings HSA with our previous HSA option and gave employees the choice of temporarily continuing with their existing HSA or transferring their account to HealthSavings for free.

Result: *In the first six months, half of Dimensional's employees with HSAs had transferred their accounts to HealthSavings.*

Step 2: Offer Ongoing Education

HSAs are often mentioned along with other listed benefits in open enrollment meetings and then not brought up until the next enrollment period. Dimensional and HealthSavings provided employees with many opportunities to learn about HSAs.

During hour-long meetings, experts from HealthSavings explained the costs and benefits of HSAs as well as logistics and regulations. HealthSavings created a custom PowerPoint presentation for these meetings (as well as a series of helpful infographics) that our employees could share with family members. Meetings were held at different times to accommodate employees' schedules.

Tax Advantages of HSAs

Contributions are typically made with pre-tax dollars, through payroll deductions by employers, which means they are not included in gross income and not subject to federal income taxes. In most states, contributions are not subject to state income taxes. Withdrawals are not subject to federal (or in most cases, state) taxes if used for qualified medical expenses. Earnings from any interest or capital gains on the money in an HSA is also tax free.

An informational article, "Health Savings Accounts: New Tool for Retirement," was circulated in case employees were unable to attend a meeting.

HealthSavings also created a short video illustrating the useful concept of "shoeboxing."[4] Using this strategy, participants pay out of pocket for eligible medical expenses, archive the receipts, invest their HSA funds, and then reimburse themselves at a later time (such as retirement). "Shoeboxing" allows HSA accountholders to withdraw tax-free funds to reimburse qualified medical expenses in the future and spend these funds with no tax penalty.

The following year, Dimensional again held employee meetings to highlight the HealthSavings HSA option. After the new HSA had been available for more than a year, the firm also migrated all HSA account holders to the new HSA. Today, all of our new employees who meet HSA eligibility requirements can become account holders.

Results

As of November 2019, Dimensional has seen healthy increases in the number of our employees with HSAs and the number of invested HSA balances:

- The percentage of HSA funds invested increased approximately fourfold (from an estimated 20 percent to 79 percent).
- The average employee's HSA balance was more than $7,000 (more than 25 percent higher than the industry average).[5]
- 51 percent of employees with HSAs had not withdrawn any money in the past 12 months (which suggests that they are committed to saving for the future).

Conclusion

Health savings accounts can be a powerful tool. Proper plan design, education, and communication can help your employees understand the need and mechanics of using their health savings accounts for greater effectiveness.

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Disclosure:

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[1] "Savings Medicare Beneficiaries Need for Health Expenses," Employee Benefit Research Institute Issue Brief No. 460 (October 8, 2018). ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_460_medicare-8oct18.pdf?sfvrsn=5c1b3e2f_2

[2] 2019 Midyear Devenir HSA Research Report. devenir.com/wp-content/uploads/2019-Midyear-Devenir-HSA-Research-Report-Executive-Summary.pdf

[3] 2019 Health Savings Account Landscape. morningstar.com/lp/hsa-landscape

[4] For more information on "shoeboxing," see healthsavings.com/hsa-strategies/#shoebox

[5] PSCA 2019 HSA Survey. psca.org/2019HSASurvey