Tangohealth
A Benefitfocus Company

What You Need to Know About Investing Your HSA Funds

A GUIDE FOR THE FORWARD-THINKING EMPLOYEE

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INTRODUCTION

If your company offers a high-deductible health plan (HDHP), there's a good chance you've been introduced to a health savings account—otherwise known as an HSA.

While it's true HSAs are piggy banks to save for medical expenses, the term "savings account" only describes one aspect of HSAs!

Your HSA is much more than a typical savings account. For instance, did you know that HSA funds you don't spend on qualified medical expenses can be stashed away for later and invested? Or you can pay for health expenses outside of your HSA so you can invest and grow your balance, while taking a withdrawal later down the road?

In this guide, we're covering the topic of investing your HSA funds. But before we dive in, let's lay the groundwork for our discussion by looking at some basic HSA facts.

5 MUST-KNOW FACTS ABOUT HSAs

If you already have an HSA, you might be tempted to skip over this section. However, we'd encourage you to keep on reading. And here's one reason why.

According to a publication by the Insured Retirement Institute...

> "Among those who report being at least somewhat knowledgeable with HSAs, 2 in 5 mistakenly believe that balances must be spent by the end of the year or forfeited."

The takeaway? It couldn't hurt to brush up on the basics about HSAs.

Here are 5 important facts to know:

1 HSAs are only for HDHP enrollees.

According to the IRS, if you want an HSA, you need to be "covered under a high deductible health plan (HDHP)." In other words, if your annual deductible is only $500 or you have small co-pays, opening an HSA isn't an option.

2 Know your contribution limits.

Like your 401(k) or IRA, your HSA will have yearly contribution limits. A recent IRS publication reveals "self-only coverage" comes with a $3,550 contribution limit for 2020. However, the IRS provides a generous bump if your HDHP provides coverage for you and your family: The 2022 family contribution limit is $7,300.

3 Your HSA funds roll over.

If you have an FSA, then you might know FSAs have a "use it or lose it" policy. The good news is your HSA is just the opposite. Unused HSA funds carry over each year and remain yours to use for future healthcare expenses...even if that's 30 years from now.

These rollovers make it possible to use your HSA funds for long-term investments, something that isn't possible with an FSA.

4 HSAs have a triple-tax advantage.

When you contribute to an HSA, you can enjoy three distinct tax advantages:

- Your contributions are pre-tax. Your HSA payroll deductions provide contributions on a pre-tax basis—meaning every dollar you contribute from your paycheck is free of income and payroll tax.
- You can make tax-free withdrawals for healthcare expenses. Unlike your 401(k) or an IRA, you will never be taxed on distributions from your HSA as long as you're paying for qualified medical expenses.
- Your earnings are tax free. The third tax advantage happens when you invest your HSA funds. Any interest earned by your HSA investments is not subject to federal or state taxes. However, state regulations require residents in Alaska, California, and New Jersey to pay a state tax on any investment growth.

You can read about an HSA's triple-tax advantage in Tango Health's *Why Opening an HSA Is a Must for Your High-Deductible Health Plan*.

5 Your HSA allows you to reimburse yourself years later.

You might know your HSA account can reimburse out-of-pocket medical bills. But did you know your HSA doesn't have an expiration date on when you can pay yourself back? Whether the expense is a doctor visit or a pair of glasses, you can get an HSA reimbursement even 35 years later—when you're in retirement.

USING YOUR HSA FOR RETIREMENT: MAKING THE SHIFT

We hope you begin to see your HSA isn't just a savings account for medical expenses. It's also a wealth-building vehicle. **Investopedia even goes so far as to write "the best way to use an HSA is to treat it as an investment tool that will improve your financial picture in retirement."**

Following this advice may mean taking the road less traveled.

As the Insured Retirement Institute notes, only about 1 in 4 employees leverage their HSAs "for future healthcare expenses." The Institute writes...

> "For now, preserving an HSA account balance as an opportunity for tax-free growth and as a financial hedge against retirement healthcare costs is still an uncommon strategy."

The Employee Benefit Research Institute confirms this fact. The organization notes, "In 2017, 5 percent of accounts had investments other than cash."

Investing your HSA may not be what everyone else is doing. Nevertheless, here are two important benefits of making this shift:

1. Your HSA will help you get prepared—so you're not surprised.

When it comes to retirement, you (literally) can't afford to be surprised by healthcare costs. According to Money.com:

> "The average couple retiring in 2019 at age 65 will need $285,000 to cover health care and medical costs in retirement, according to an annual estimate by Fidelity."

Your HSA account allows you to grow funds for Medicare premiums, copays, deductibles, and prescription drugs.

2. Your HSA won't be limited to qualified medical expenses.

As long as you use your HSA for qualified medical expenses, you will never pay federal taxes for funds you contribute. At the same time, it's important to remember that HSA dollars can be used for general expenses after age 65.

While HSA withdrawals for non-qualified medical expenses are subject to federal income taxes similar to a 401(k), these distributions are exempt from a 20% federal tax penalty after 65.

This is a benefit that's well worth your consideration. In fact, Investopedia cites one expert who notes, "Maxing out contributions before age 65 allows you to save for general retirement expenses beyond medical expenses."

USING HSA DOLLARS FOR CURRENT MEDICAL BILLS

When it comes to HSAs, some people may avoid using HSA dollars for current medical bills and invest all funds for future qualified expenses.

Investopedia recommends treating your HSA contributions similar to your 401(k), advising you "to never spend your HSA contributions during your working years and pay cash out of pocket for your medical bills." Of course, the more HSA dollars you invest, the more those funds can grow.

However, we'd recommend taking this advice with a grain of salt.

If you're able to invest your entire HSA, great! But what if this approach isn't feasible for you and your family? Some people need to use their HSAs to pay for healthcare expenses. In this case, you might take a hybrid approach, using some of your funds while saving part of your contributions for later.

Here's a graphic that shows the power of a hybrid approach. These numbers were calculated using Bank of America's HSA savings calculator with the retirement variable set to age 65 and the investment return variable set to 6%.

If you have a family health plan...

Age	Yearly Contribution	HSA Funds Spent Each Year	HSA Nest Egg
30	$7,100	$650	$768,330
40	$7,100	$650	$381,559
50	$7,100	$650	$165,588

If you have an individual health plan...

Age	Yearly Contribution	HSA Funds Spent Each Year	HSA Nest Egg
30	$3,550	$650	$345,451
40	$3,550	$650	$171,554
50	$3,550	$650	$74,450

As you can see, even if you spend some of your HSA funds each year, you can still reap big rewards. The key is to save more than you spend. As long as you have enough HSA dollars to meet the minimum amount needed to invest, your HSA can further support your retirement goals.

DETERMINING HOW MUCH TO INVEST

If you decide to take a hybrid approach, you might wonder...

"How much cash should I keep in my HSA, and what portion should I invest?"

This is an important decision, and below we're giving some general guidelines to consider—ranging from the most conservative hybrid approach to the least conservative hybrid approach.

1. Consider if you want enough HSA funds to cover all eligible medical expenses.

Medical expenses don't usually end when you meet your annual deductible. (Your deductible is the amount you owe for covered healthcare services before the insurance company begins to pay a portion of your medical bills.)

Even if you've paid your deductible, you may still need cash for a copay, coinsurance, or expenses that aren't covered by your health plan, but are covered by your HSA (such as dental work).

As you consider how much money to invest, look at your anticipated out-of-pocket medical expenses for the year including other anticipated healthcare costs. A personalized benefits decision support tool like Tango Decision Assist can help you more accurately estimate your expected expenses.

2. Consider keeping enough money to cover your annual deductible.

Some experts recommend investing enough in your HSA to cover your annual deductible. Depending on your risk comfort level and current HSA balance, you might decide to leave enough in your HSA to cover this sum.

Let's say your spouse is considering a job switch and anticipates a brief period of unemployment. In this situation, it's a good idea to keep enough cash in your HSA to cover your deductible in case a medical emergency arises during the transition.

3. Consider whether you want to use your HSA as a "buffer."

Perhaps you don't need your HSA to cover your deductible. But you do want your HSA to act as a buffer, lessening the impact of your medical bills.

For this approach, you'll need a total of all your anticipated healthcare expenses for the year. Then, determine the maximum amount you'd be comfortable withdrawing from your regular checking account to pay medical bills. The difference between the two numbers is the amount you'll need in your HSA. Here's what we mean.

Next year, you anticipate spending $2,000 in medical bills—that's a $1,800 deductible and $200 in further cost sharing. You don't mind paying $1,200 toward these expenses. But that extra $800 begins to place a strain on your wallet. In this case, aim to keep at least $800 of uninvested funds in your HSA. You can reimburse yourself for the $1,200 at a later point if you find you need it.

No matter which hybrid approach you take, the key to investing your HSA is following a very basic financial rule: **Take in more than you spend.**

Whether you need enough for your out-of-pocket maximum or $500 to lessen the impact of a few medical bills, be sure your HSA contributions leave enough money to invest for retirement.

→ **Important Tip:** Keep in mind HSA investments aren't liquid. If you invest a portion of your HSA funds, you'll lose immediate access to the cash value until the investment is liquidated.

If you need to access your HSA investments to pay for claims, your invested assets will first be transferred to a cash position before you can use the funds to pay for eligible medical expenses. Some investments may have a settlement period before the assets are deposited into your HSA. So allow for time between your transaction(s) and using your HSA funds.

BEFORE YOU START INVESTING...

Before you invest your HSA funds, we recommend you ask yourself three important questions, which we've listed below:

1 When do I plan to retire?

Knowing your retirement date can assist in determining your personal risk level and what type of investments to choose. In general, you should select an investment with a target asset mix appropriate to your time horizon. In other words, your investments should reflect the right kind of risk level based on your age. With age, most people take less risk to make sure their investments help them save more instead of ending up in a loss. The longer you hope to let your HSA balance grow, the more aggressive you can be.

2 What are my investment goals?

Try to determine the exact percentage of growth you want to achieve. For instance, are you looking to grow your funds by 10% so you can achieve early retirement? Are you simply wanting to ensure your investments stay a few percentage points above inflation? Knowing your goals will help you narrow down your options as you evaluate mutual funds, stocks, and other investments.

3 Have I acknowledged my risk?

Just like a 401(k) investment, keep in mind investing involves risk. The values of your investment will fluctuate over time, and you may gain or lose money. Keep this in mind so you're not worried when you see your mutual fund has decreased by 5% in a single year. It may easily increase by 15% in the next two years.

INVESTING YOUR HSA FUNDS

You're convinced your HSA can support your retirement dreams. You've pinpointed the amount of money to contribute annually. You've evaluated your goals.

What's next? Here are our tips for beginning to invest your HSA.

Begin by exploring.

Betterment recommends you "know what your investment options are," noting your HSA investment vehicles can vary.

We would agree with this suggestion. Some HSAs provide self-directed investing where you can place your money in stocks, bonds, and mutual funds, but other HSAs limit investing to mutual funds.

Having information on what's available will shape your next steps...and potentially save you from extra work. There's no need to subscribe to the *Wall Street Journal* to read up on stocks if your HSA doesn't allow stock-market transactions. Check your HSA provider's website for more details on which investments are available and the minimum investment needed.

So start your investment journey with some exploration before you conduct heavy research.

Choose the best investment vehicle(s).

You'll want to narrow your research to the investments that match your goals. As mentioned previously, your investments should reflect your age-appropriate risk level. Below is a chart that gives a short description of each investment along with its associated risk.

Investment	Definition	Risk Level
Bond	An investment that is a loan given to a government entity or company with a promise of being paid back with interest.	Low
Certificate of Deposit (CD)	An investment that "is a bank account that pays you a higher interest rate in return for locking your money away for a certain period of time." (Source)	
Money Market Account (MMA)	An investment that "is a savings account that may come with higher interest rates than other savings accounts plus checks or a debit card." In addition, "MMAs often require much higher minimum deposits and balances." (Source)	
Exchange-Traded Fund (ETF)	An investment that is a "basket" of other investment vehicles. An ETF can be traded like the stock market.	
Mutual Fund	An investment that "pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt. The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds. Each share represents an investor's part ownership in the fund and the income it generates." (Source)	
Stock	An investment that gives partial ownership of a company.	
Futures Contract	An investment that "is a legal agreement to buy or sell a particular commodity or asset at a predetermined price at a specified time in the future." (Source)	
Options Contract	An investment that gives you the "option" to buy or sell stocks (or other investment vehicles) at a certain price.	High

→ **Important Tip:** Research the level of involvement required for a particular investment. For instance, you're going to need much more involvement in researching a stock than you will in researching a US Treasury bond.

Look at the data.

At this point, you're not researching whether to invest in stocks, bonds, or another investment. Rather, you're seeing ***which*** stocks you should buy or ***which*** bonds you should purchase.

Looking at the data can help you distinguish between the investment that's good versus the investment that's best.

Let's say you've decided to put a chunk of your HSA in a mutual fund. There are several funds that meet your desired risk level. So how do you know which is the best? As you start looking at the data on each fund, you might find:

- **There are differences in track records.** You might discover one mutual fund has only existed for five years while another has been around for 15 years.
- **There are differences in portfolios.** One mutual fund may have a larger percentage of healthcare investments. Another mutual fund may have more invested in the financial services sector.
- **There are differences in returns.** During research, you might find one mutual fund has a slightly higher average return than a similar fund.

We're not saying you need to become a Certified Financial Planner. What we are saying is you need to look at the data on potential investments. A little common sense can go a long way.

Don't rely on a single opinion.

Whether you're buying a car or going to the doctor, there's value in getting multiple opinions for important decisions. Your HSA investments are no different.

Make sure you're not relying on a single viewpoint for your investment decisions.

For instance, don't buy a stock because you read a glowing article on Forbes about a company. Be sure you understand the overall market, the industry the organization operates in, and what multiple experts say about the company. All of these lessen the likelihood of making a biased or misinformed decision.

Practice diversification.

There's a reason diversification is a well-known investing principle. The natural cycle of investing includes gains and losses. Diversification spreads your risk and ensures that if something happens to one investment, you have backup assets.

To minimize the risk of loss, try to have a diverse portfolio of investments and a diverse mix across multiple asset classes to balance your risk.

Avoid investing all your funds in…

- **Any single industry.** For instance, don't place all your HSA dollars in the biotech niche or in the manufacturing sector.
- **Any single company.** A time-honored stock may appear to be solid, but it's not wise to stake your retirement future on one organization.
- **Any single investment vehicle.** You'll want to consider investing your portfolio in a mixture of stocks, bonds, or other wealth-building vehicles.

Read the fine print.

When it comes to HSAs, Betterment recommends looking into the fees, noting that HSAs can have "less transparency" compared to 401(k)s. They also recommend understanding the withdrawal rules of your HSA. This brings up an important point.

You need to read the fine print.

From the time it takes for a position to settle to the amount you're charged for buying or selling an investment, the fine print matters.

Stay involved.

Be sure you keep an eye on your investments. Company deterioration, changing economic trends, or other factors can turn a good investment into a bad one. So continue to evaluate your HSA investments and whether they are right for you and your financial situation.

Understand HSA beneficiary rules.

It's important to understand what the IRS has to say about HSAs and beneficiaries. To see why, listen to what *Kiplinger* editor Kimberly Lankford has to say:

> "If you don't designate a beneficiary for the account, the money will be included in your estate and the value will be taxable on your final income tax return. That's why it's important to designate a beneficiary for your HSA."

We'd encourage you to read Lankford's article. However, you can also visit the IRS online and find information on this topic here.

IMPROVING YOUR FINANCIAL WELLNESS

Investing your HSA for retirement is a wise tactic. However, it's only one part of an even bigger goal: financial wellness.

Achieving financial wellness can include investing your HSA. But it also involves other important behaviors, such as making a budget, reducing debt, and more.

At Tango Health, we've created a resource to help you work toward financial wellness, and we'd encourage you to download our free guide *Achieving Financial Wellness: 4 Steps for Improving Your Personal Finances & 401(k) Savings*.

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