Saving for Health Care in Retirement: How HSAs and 401(k)s Fit Together

EBRI Webinar

June 9, 2021

Speakers

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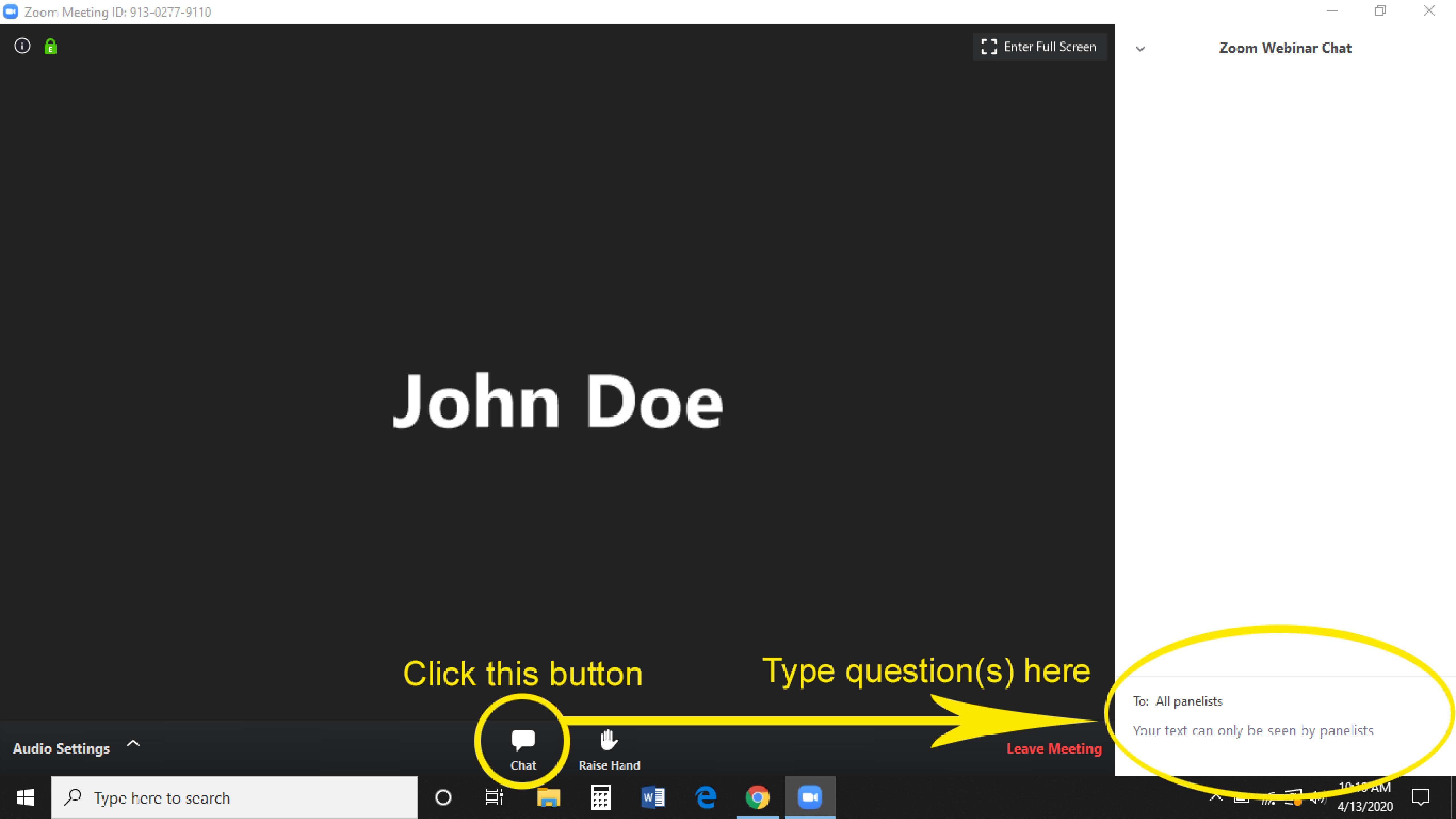
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Saving for Health Care in Retirement: How HSAs and 401(k)s Fit Together

Employee Benefit Research Institute

June 9, 2021

The Brutal Facts

- Medicare does not cover all expenses – deductibles & coinsurance, no out-of-pocket maximum
- Medicare Part B premium
- Medigap plans have premiums
- Medicare drug plans have deductibles and coinsurance
- Medicare Advantage plans often have premiums and cost sharing
- Fewer employers offering retiree health benefits
- Fewer retirees eligible for retiree health benefits

Needed Savings for Health Care Expenses in Retirement Depend on Various Factors

- Retirement age.
- Age at time of death.
- Availability of insurance to supplement Medicare.
  - Source of supplemental coverage
  - Premium for supplemental coverage
  - Annual premium increases.
- Health status.
- Out-of-pocket expenses.
- Rate of return on savings.
- Premiums for supplemental insurance.

EBRI Issue Brief

May 28, 2020 • No. 506

A Bit of Good News During the Pandemic: Savings Medicare Beneficiaries Need for Health Expenses Decrease in 2020

But Some Couples Could Need as Much as $325,000 in Savings

By Paul Fronstin, Ph.D., and Jack VanDerhei, Ph.D., Employee Benefit Research Institute

AT A GLANCE

In 2020, the predicted saving targets for Medicare beneficiaries to cover health premiums, deductibles, and certain other health expenses in retirement have fallen between 8 and 10 percent since 2019. These are the biggest declines we have seen since 2012, with the exception of 2013, when needed savings declined between 6 and 11 percent. Savings are needed to pay for premiums for Medicare Parts B and D, the Part B deductible, premiums for Medigap Plan G, and out-of-pocket spending for outpatient prescription drugs.

The data used in EBRI's analysis come from a variety of sources. EBRI employs a Monte Carlo simulation model for this evaluation that simulated 100,000 observations, allowing for the uncertainty related to individual mortality and rates of return on assets in retirement.

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EBRI's Retiree Health Savings Model

- Monte Carlo simulation model
- Simulated 100,000 observations
- Allows for uncertainty related to individual mortality and rate of return in retirement
- Observations used to determine asset targets for having adequate savings 50%, 75% and 90% of the time.

- Separate estimates for men and women.
- Joint estimates for married couple.
- Estimates for persons with Medigap Plan F & Medicare Part D.

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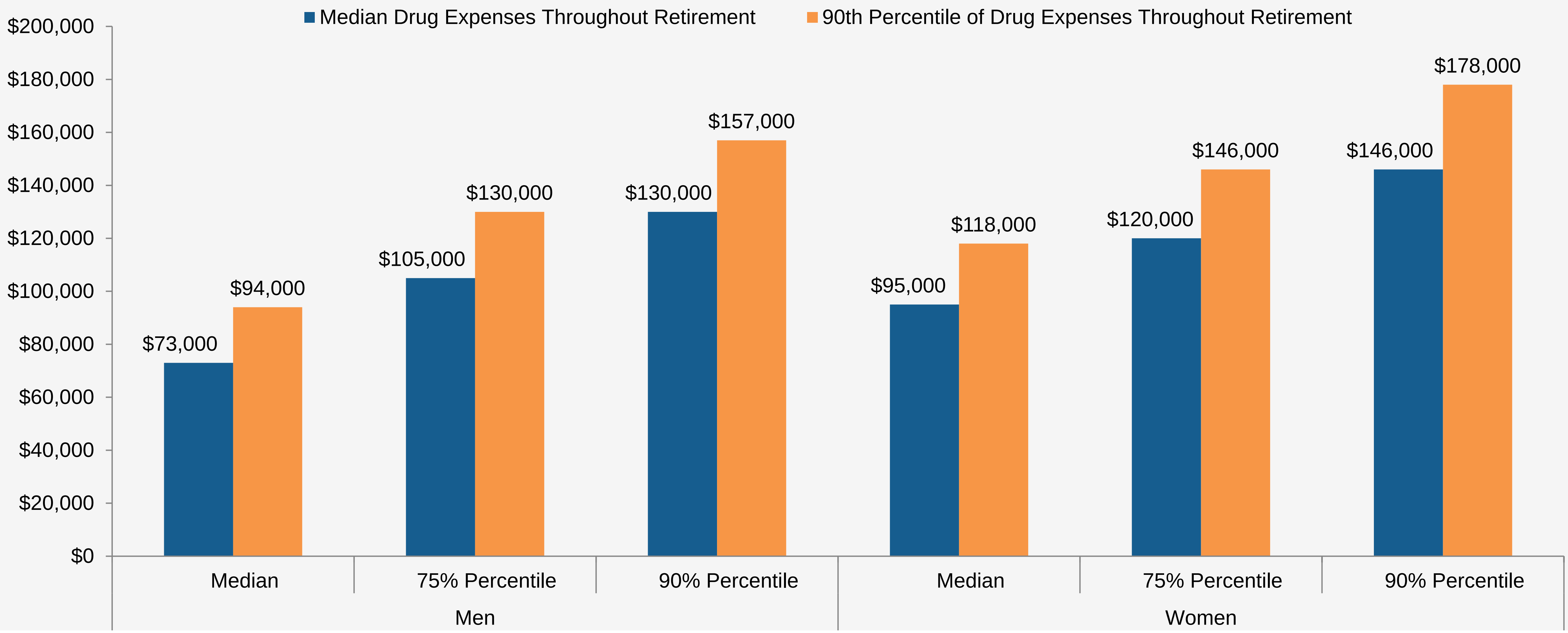
Savings Needed for Medigap Premiums, Part B Premiums, Part D Premiums, and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2020



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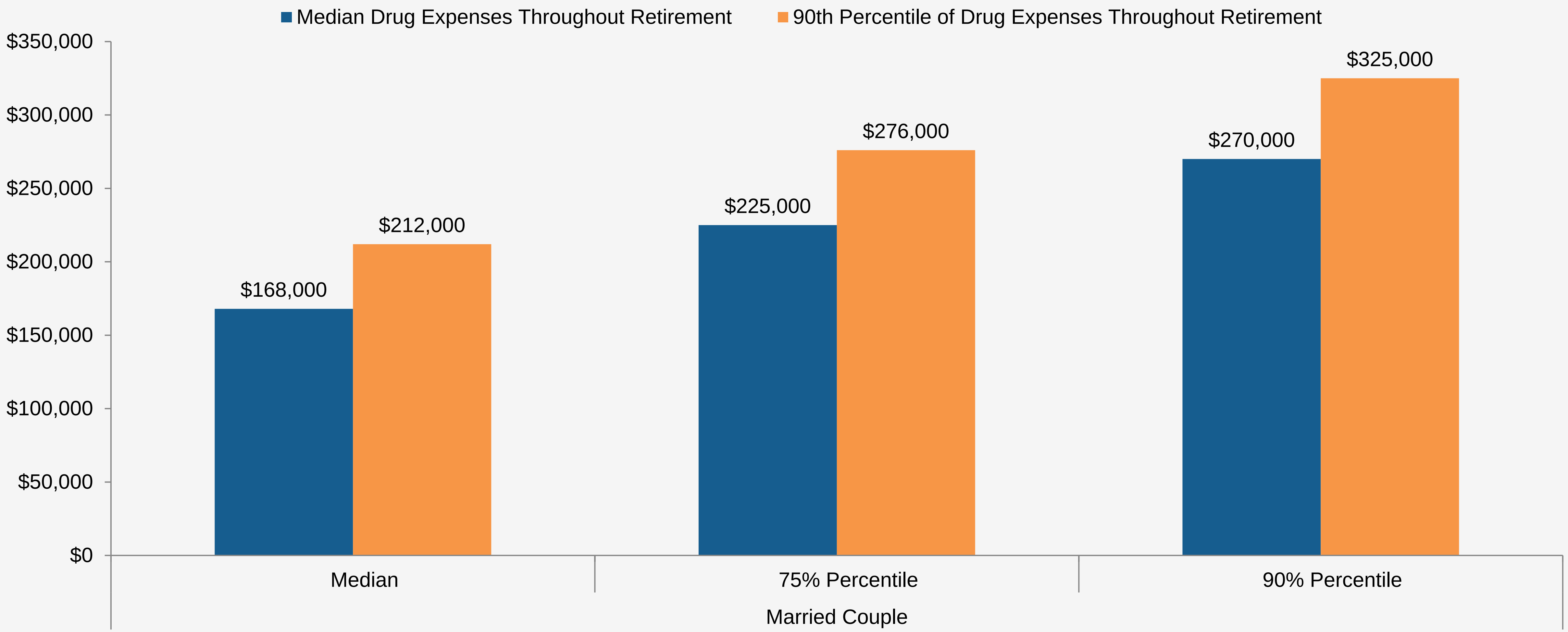

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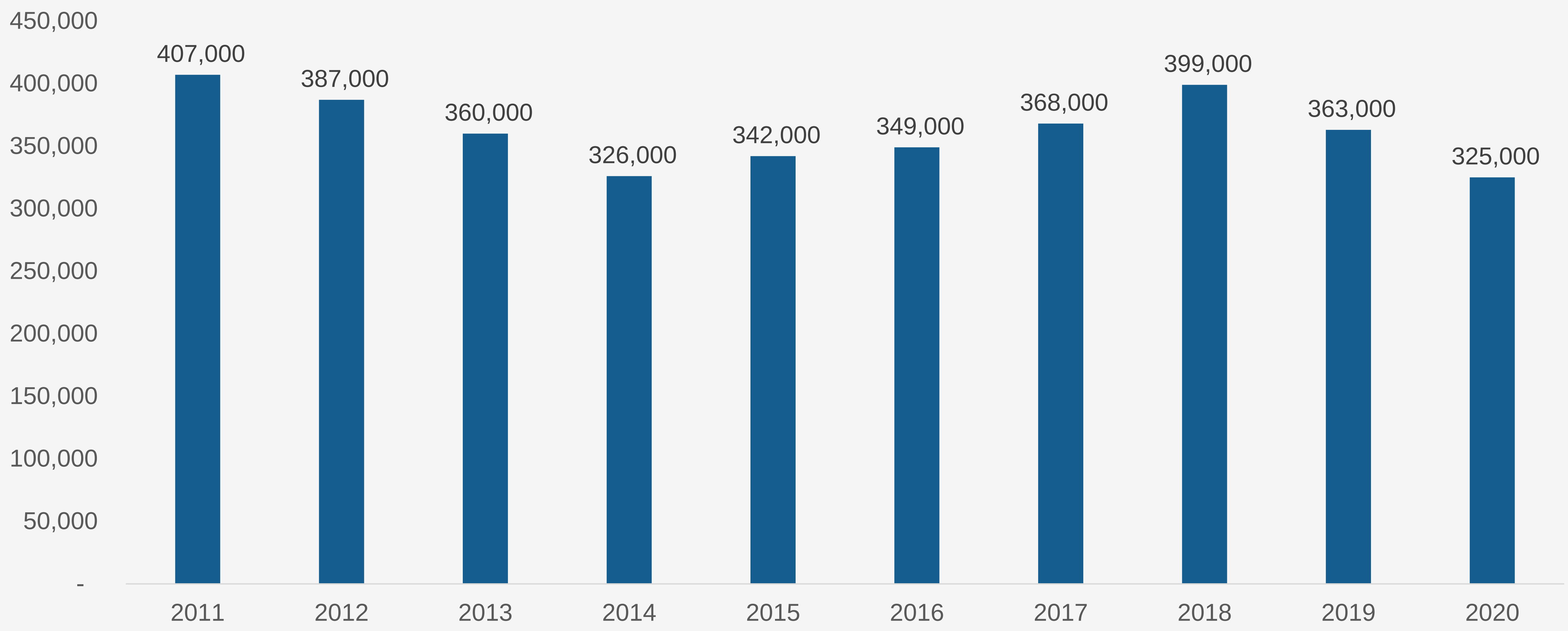
Savings Needed for Married Couple, 2011-2020
90% Chance of Having Enough Savings: 90th Percentile Drug Expenses



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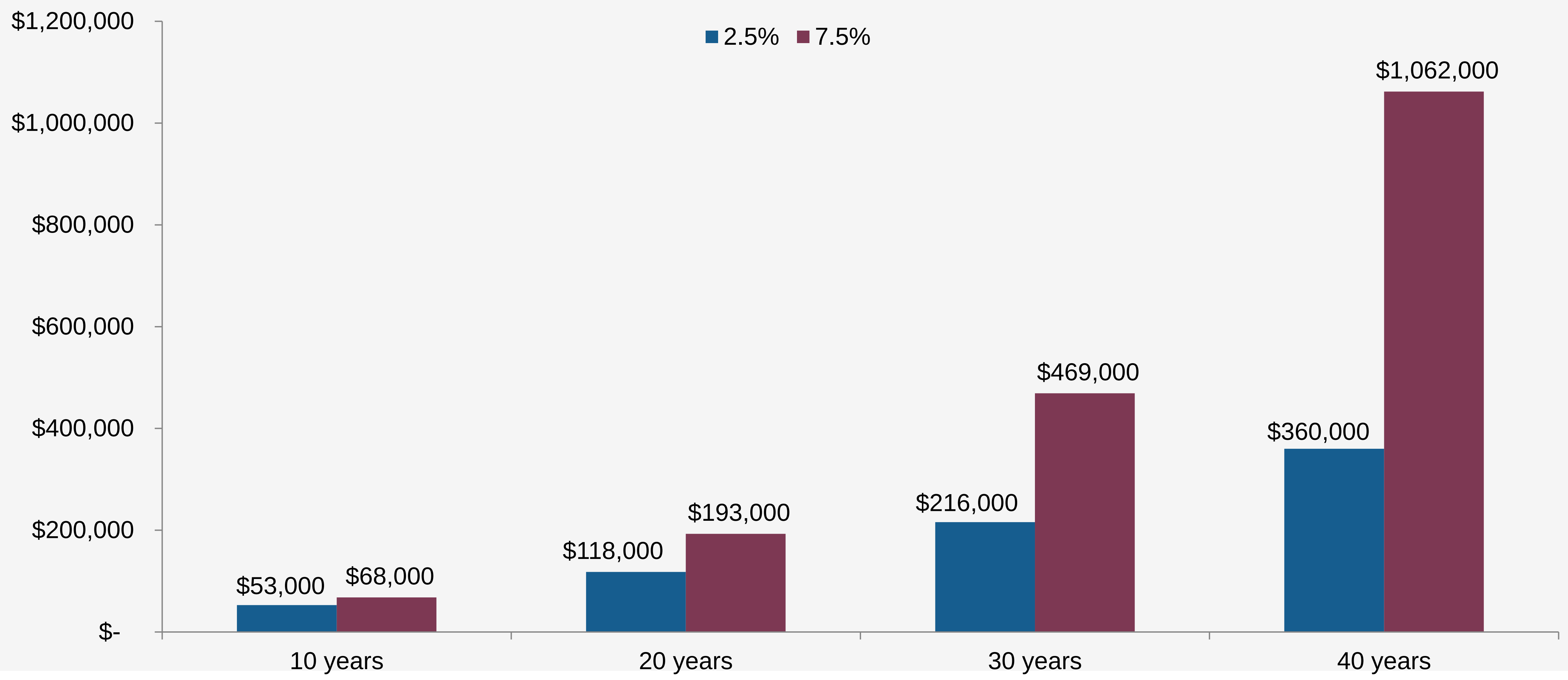
HSAs as a Retirement Savings Vehicle

- Triple tax advantage – contributions, growth and distributions all tax-free
- Pre- tax contributions limited to $3,600 per individual/$7,200 per family in 2021
- Must enroll in HSA-eligible health plan (HDHP) to make contribution to HSA
    - Deductibles can not be lower than $1,400 employee-only coverage/$2,800 family coverage
- $1,000 “Catch-up” contribution allowed for individuals 55+
- No “use-it-or-lose-it” rule

Potential Accumulated Savings in HSA, by Years Saved and Potential Rate of Return (assuming no distributions)



RETIREMENT INSIGHTS

Guide to Retirement℠

2021 Edition

J.P.Morgan
Asset Management

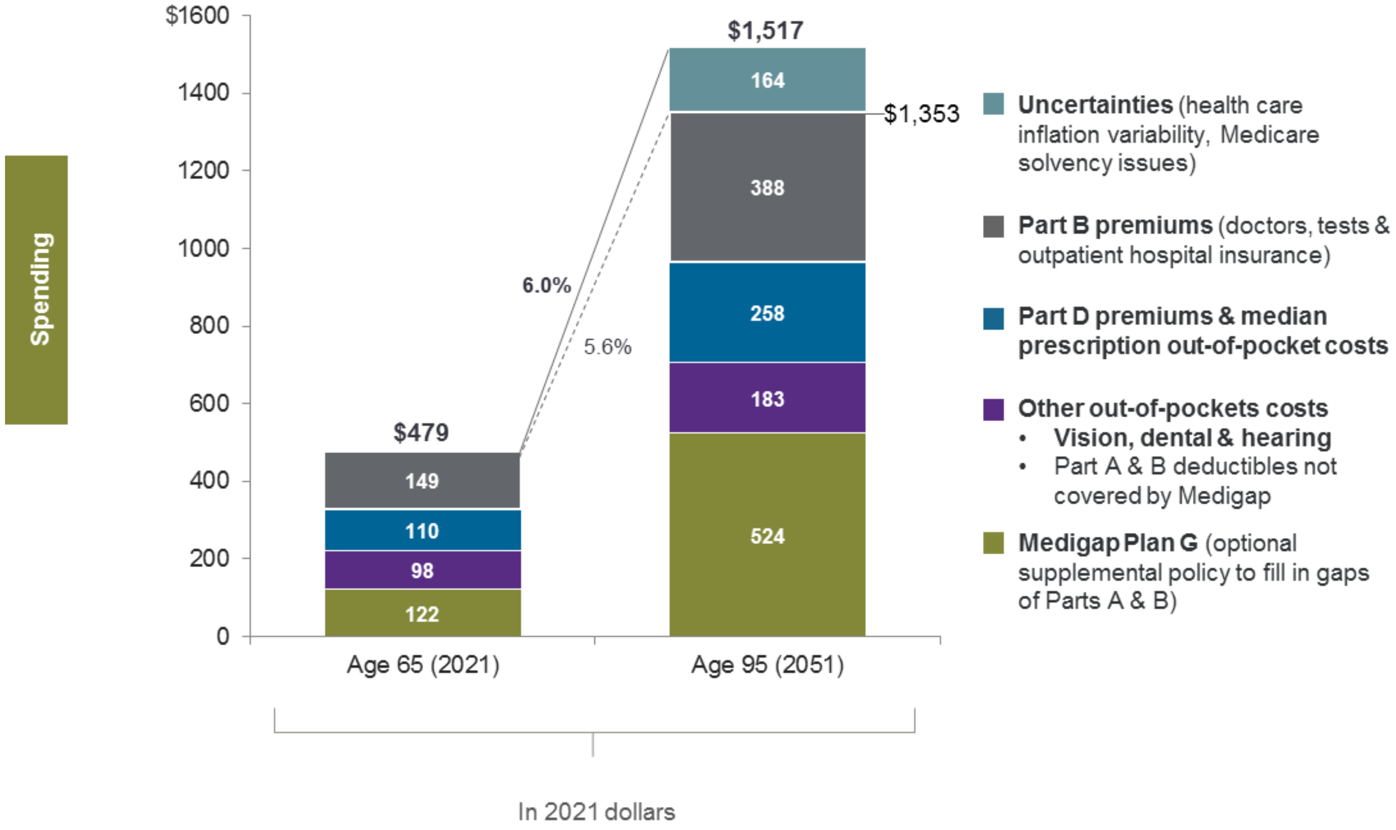
Agenda

1) Annualized view of health care expenses

2) Prioritizing savings

3) Account type matters

Original Medicare costs in retirement (in 2021 dollars)
Monthly amount per person



A GROWING CONCERN

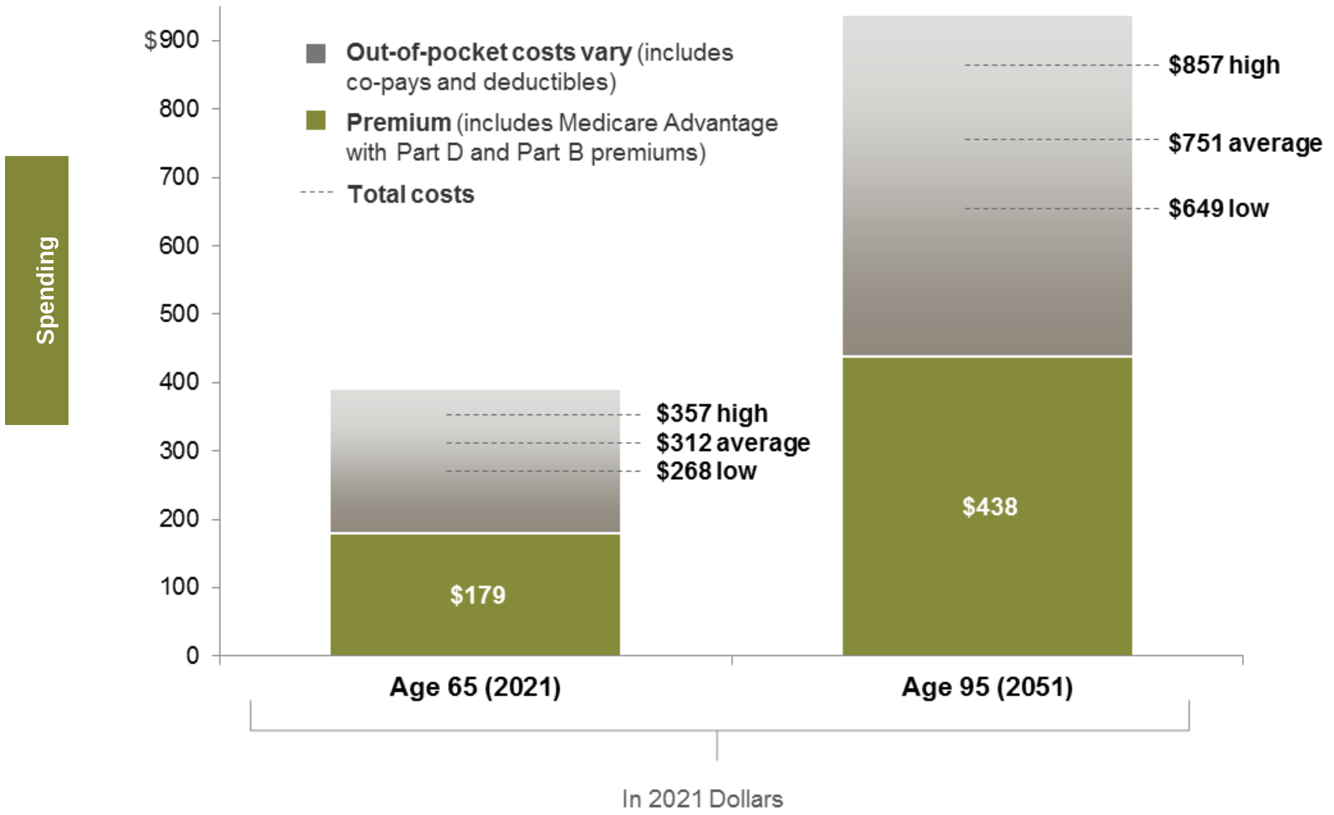
Annual expenses per person in 2021 are $5,740.

Given variation in health care cost inflation from year to year, it may be prudent to assume an annual health care inflation rate of 6.0%, which may require growth as well as current income from your portfolio in retirement.

Estimated future value total median monthly cost at age 85 is $2,747. Today's dollar calculation used a 2% discount rate to account for overall inflation. Medigap premiums typically increase with age, in addition to annual inflation, except for the following states: AR, CT, MA, ME, MN, NY, VT, WA. For options available in other states, contact the State Health Insurance Assistance Program (SHIP) https://www.shiptacenter.org/. Plan G premium is nationwide average for non-smokers. If Plan G is not available, analysis includes the most comprehensive plan available.

Source: HealthView Services proprietary data file received January 2021, used by permission. 2019 Consumer Expenditure Survey, latest available data as of December 31, 2020, J.P. Morgan analysis.

Estimated Medicare Advantage with Part D and out-of-pocket expenses
Monthly amount per person



DRAMATIC DIFFERENCES IN COSTS DEPENDING ON HEALTH

Be prepared to pay more for health care in the event you experience a health issue, which becomes more common as one ages.

- Be aware: Although Medicare Advantage plans have out-of-pocket caps, those limits do not include prescriptions.
- Consider maintaining an emergency reserve fund for high out-of-pocket cost periods.

Total costs = annual premium + out-of-pocket costs. High costs: weighted average of medical costs (70th percentile) and prescription costs (65th percentile. Low costs: weighted average for medical costs (25th percentile) and prescription costs (35th percentile). Plans include Part D and exclude those with subsidies for low income beneficiaries.

Estimated future value of total median costs at age 95 is $1,360. Cost estimates include increased use of medical care at older ages. Premiums will vary based on plan characteristics. Out-of-pocket expenses will vary by plan and include co-pays and deductibles.

Source: HealthView Services, proprietary data file received January 2021, used by permission.

Agenda

1) Annualized view of health care expenses

2) **Prioritizing savings**

3) Account type matters

Prioritizing long-term retirement savings

Prioritizing savings

DC

- **9** — **Taxable account**
- **8** — **IRA**[3]
- **7** — **Pay down lower interest loans**
  (such as student loans with interest < 5.75%)[2]

Maximize contribution

- **6** — **Additional Defined Contribution savings**
- **5** — **Additional HSA (Health Savings Account)**[1]

- **4** — **Pay down higher interest loans**
  (such as credit card debt / student loans with interest > 5.75%)[2]

Maximize employer match

- **3** — **Defined Contribution savings to maximize employer match (if available)**
- **2** — **HSA (Health Savings Account) if eligible for match**[1]

Start here

- **1** — **Emergency reserve (3 – 6 months of living expenses)**

GETTING STARTED

Start with emergency savings and make sure to take advantage of employer matching funds if they are available.

An HSA offers triple tax benefits if used for qualified medical expenses in retirement. Prioritize contributions to an HSA before a Defined Contribution plan if current medical expenses can be funded from low cost sources.[4]

[1]Must have a high-deductible health insurance plan that is eligible to be paired with an HSA. Those taking Social Security benefits age 65 or older and those who are on Medicare are ineligible. Tax penalties apply for non-qualified distributions prior to age 65; consult IRS Publication 502 or your tax professional.

[2]This assumes that a diversified portfolio may earn 5.75% over the long term. Actual returns may be higher or lower. Generally, consider making additional payments on loans with a higher interest rate than your long-term expected investment return.

[3]Income limits may apply for IRAs. If ineligible for these, consider a non-deductible IRA or an after-tax 401(k) contribution. Individual situations will vary; consult your tax professional.

[4]Examples of low cost funding sources include cash and current income.

Source: J.P. Morgan analysis. Not intended to be a personal financial plan.

Agenda

1) Annualized view of health care expenses

2) Prioritizing savings

3) Account type matters

	Contributions[1]	Investment growth	Withdrawals
Pre-tax 401(k) / Traditional IRA	+	+	− (Taxed as ordinary income)
Roth 401(k) / Roth IRA	−	+	+ (For qualified withdrawals)
After-tax 401(k) / non-deductible Traditional IRA	−	+	− (Investment returns taxed as ordinary income)
Health Savings Account (HSA)[3]	+	+	+ (For qualified health care expenses)

Retirement accounts: Taxes generally apply to contributions or withdrawals. Most withdrawals must be qualified to avoid tax penalties.[2]

If not used for qualified health care expenses, withdrawals after age 65 will be taxed as ordinary income (without penalty).

+ **Preferential tax treatment** − **Subject to taxes**

DC

Federal taxes; states may differ. This is not intended to be individual tax advice. Consult your tax professional.

[1]Income and other restrictions may apply to contributions. Tax penalties usually apply for early withdrawals. Qualified withdrawals are generally those taken over age 59½; qualification requirements for amounts converted to a Roth from a traditional account may differ; for some account types, such as Roth accounts, contributions that are withdrawn may be qualified. See IRS Publications 590 and 560 for more information.

[2]Withdrawals from after-tax 401(k) and non-deductible IRAs must be taken on a pro-rata basis including contributions and earnings growth. For non-deductible IRAs, all Traditional IRAs must be aggregated when calculating the amount of pro-rata contributions and earnings growth.

[3]There are eligibility requirements. Qualified medical expenses include items such as prescriptions, teeth cleaning and eyeglasses and contacts for a medical reason. Cosmetic procedures, such as teeth whitening, and general health improvement, such as gym memberships and vitamins, are not qualified expenses. A 20% tax penalty applies on non-qualified distributions prior to age 65. After age 65, taxes must be paid on non-qualified distributions. See IRS Publication 502 for details.

Diversified sources of retirement funding

Account type	Investment earnings/ withdrawals	Included when calculating: Income taxes owed?	Social Security % taxed? Medicare surcharges?
Health Savings Account	Tax-free withdrawals (for qualified health care expenses)[1]		
Roth 401(k)/IRA	Tax-free withdrawals[2]		
Taxable Account	Tax-exempt interest		☑
	Ordinary dividends Taxable interest	☑	☑
	Qualified dividends	☑	☑
	Realized capital gains	☑	☑
Pre-tax 401(k)/ Traditional IRA	Taxable withdrawals (ordinary income)	☑	☑

RETIREMENT FUNDING SOURCES ARE NOT CREATED EQUAL

Investment earnings and withdrawals from tax-advantaged accounts are primary sources to fund retirement spending needs.

When building a retirement income plan, be aware of sources that may be used to determine:

- Income taxes
- How much of a Social Security benefit is subject to tax
- Additional required Medicare premiums

Qualified withdrawals from Roth or Health Savings Accounts can provide tax-free funding that is not included in means-testing of government benefits.

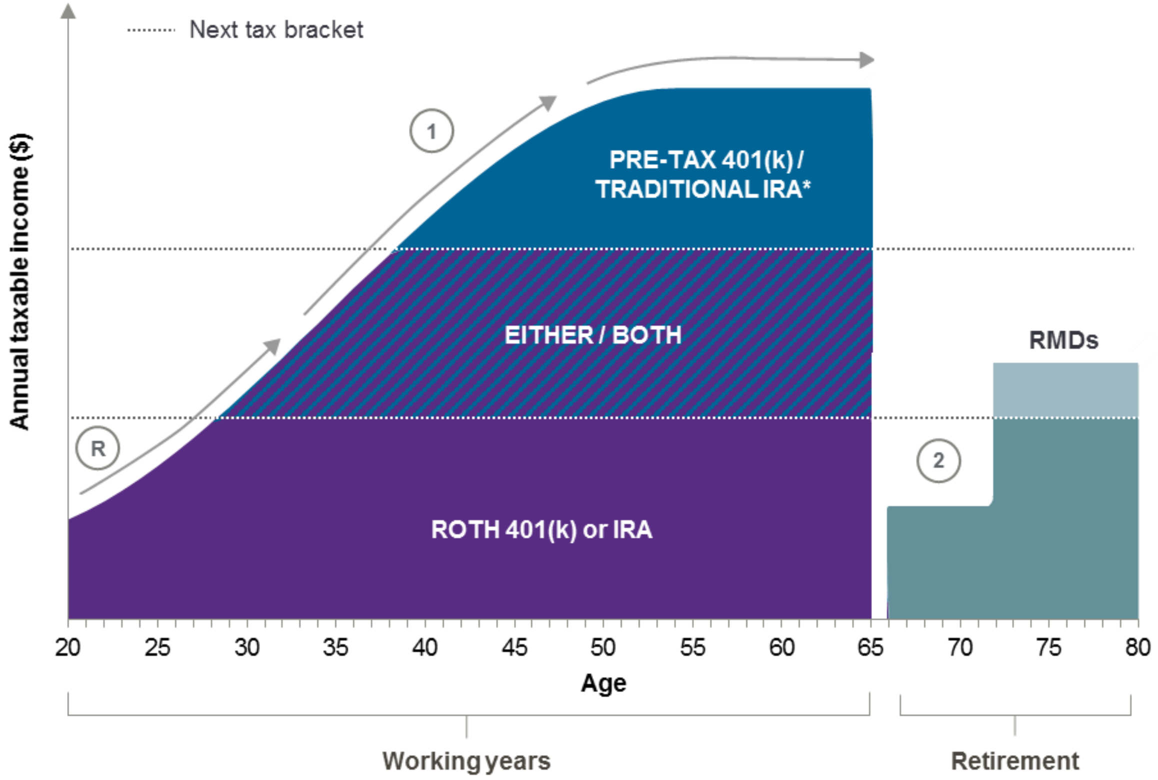
This is not intended to be individual tax advice; consult your tax professional.

[1]Must have a qualifying high-deductible health plan to make contributions. Funds in the HSA may be withdrawn tax free for qualified medical expenses unless a credit or deduction for medical expenses is claimed. After age 65 funds also may be withdrawn at ordinary income tax rates without penalty for any reason.

[2]Subject to 5-year Roth account holding period and age requirements.

Saving

Changes in lifetime taxable income
Hypothetical wage curve



TAX DIVERSIFICATION

Managing taxes over a lifetime requires a balance of your current and future tax pictures. Make income tax diversification a priority to have more flexibility and control in retirement.

Rule: Contributing to a Roth early in your career and shifting as your income increases.

1. Roth 401(k) contributions in peak earning years if wealth is concentrated in tax-deferred accounts.

2. Proactive Roth conversions in lower income retirement years if RMDs are likely to push you into a higher bracket.

*If eligible to make a deductible contribution (based on your MAGI). The illustration reflects savings options into Traditional and Roth IRA accounts, as well as into pre-tax and Roth 401(k) accounts. RMD = Required Minimum Distributions, which are typically due no later than April 1 following the year the owner turns 72 and are calculated every year based on the year-end retirement account value and the owner/plan participant's life expectancy using the IRS Uniform or Joint Life Expectancy Table. Employer contributions are typically pre-tax and are subject to tax upon distribution.

The above example is for illustrative purposes only.

Source: J.P. Morgan Asset Management.

J.P. Morgan Asset Management – Index definitions & disclosures

Unless otherwise indicated, all illustrations are shown in U.S. dollars.

Past performance is no guarantee of comparable future results.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Indices are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

The **S&P 500 Index** is widely regarded as the best single gauge of the U.S. equities market. This world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 Index focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. An investor cannot invest directly in an index.

The **Bloomberg Barclays Capital U.S. Aggregate Index** represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bonds are subject to interest rate risks. Bond prices generally fall when interest rates rise.

The price of **equity** securities may rise or fall because of changes in the broad market or changes in a company's financial condition, sometimes rapidly or unpredictably. These price movements may result from factors affecting individual companies, sectors or industries, or the securities market as a whole, such as changes in economic or political conditions. Equity securities are subject to "stock market risk," meaning that stock prices in general may decline over short or extended periods of time.

Investing in **alternative assets** involves higher risks than traditional investments and is suitable only for sophisticated investors. Alternative investments involve greater risks than traditional investments and should not be deemed a complete investment program. They are not tax efficient and an investor should consult with his/her tax professional prior to investing. Alternative investments have higher fees than traditional investments and they may also be highly leveraged and engage in speculative investment techniques, which can magnify the potential for investment loss or gain. The value of the investment may fall as well as rise and investors may get back less than they invested.

Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve.

Model Portfolio Details (Equity%/Bond%) Source: PI-AA-MODELS_4Q20 0903c02a81cfc27a

Asset class	20/80	40/60	50/50	60/40	80/20
U.S. large cap growth	4.8%	9.6%	12.0%	14.4%	19.3%
U.S. large cap value	4.8%	9.6%	12.0%	14.4%	19.3%
U.S. mid/small cap	2.5%	4.8%	6.0%	7.3%	9.5%
U.S. REITs	1.0%	2.0%	2.5%	3.0%	4.0%
Developed market equities	5.0%	10.0%	12.5%	15.0%	20.0%
Emerging market equities	2.0%	4.0%	5.0%	6.0%	8.0%
U.S. investment-grade bonds	62.8%	46.8%	38.5%	30.3%	12.5%
U.S. high yield bonds	10.5%	8.0%	7.0%	6.0%	4.5%
Emerging market debt	6.8%	5.3%	4.5%	3.8%	3.0%

Model portfolios can only be distributed by Intermediaries where Advisory Portfolios are available.

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J.P.Morgan Asset Management

What Happens to 401(k) Contributions When Workers Open an HSA?

Study Overview

- This study uses data from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project and EBRI's HSA Database to examine the impact of initial health savings account (HSA) contributions on employee 401(k) contributions.
- Data from 45,132 employees, 19 and older, with both a 401(k) and an HSA are included. The sample was constructed by examining workers who:
  - Could be followed over a two-year study period.
  - Made their first HSA contribution in the second year of the two-year study period
- Key outcomes include:
  - Probability of reducing employee 401(k) contributions in the first year that the employee began making HSA contributions.
  - Change in employee contributions to 401(k) plan the year that HSA contributions begin.
  - Rate of crowding out between 401(k) employee contributions and HSA employee contributions as a function of various factors.

Key Findings

The results show evidence that workers substituted 401(k) contributions with HSA contributions

- After opening an HSA, 401(k) contribution changes ranged from large decreases to large increases
- Overall, 56 percent of 401(k) participants *reduced* their 401(k) contributions in the first year that they made HSA contributions.
- However, at the median, the decrease in 401(k) contributions was small: only $34, or about a 1% reduction
- 401(k) contribution reductions were highest for those who made larger 401(k) contributions
- Similarly, 401(k) contribution reductions were highest for those who made larger HSA contributions

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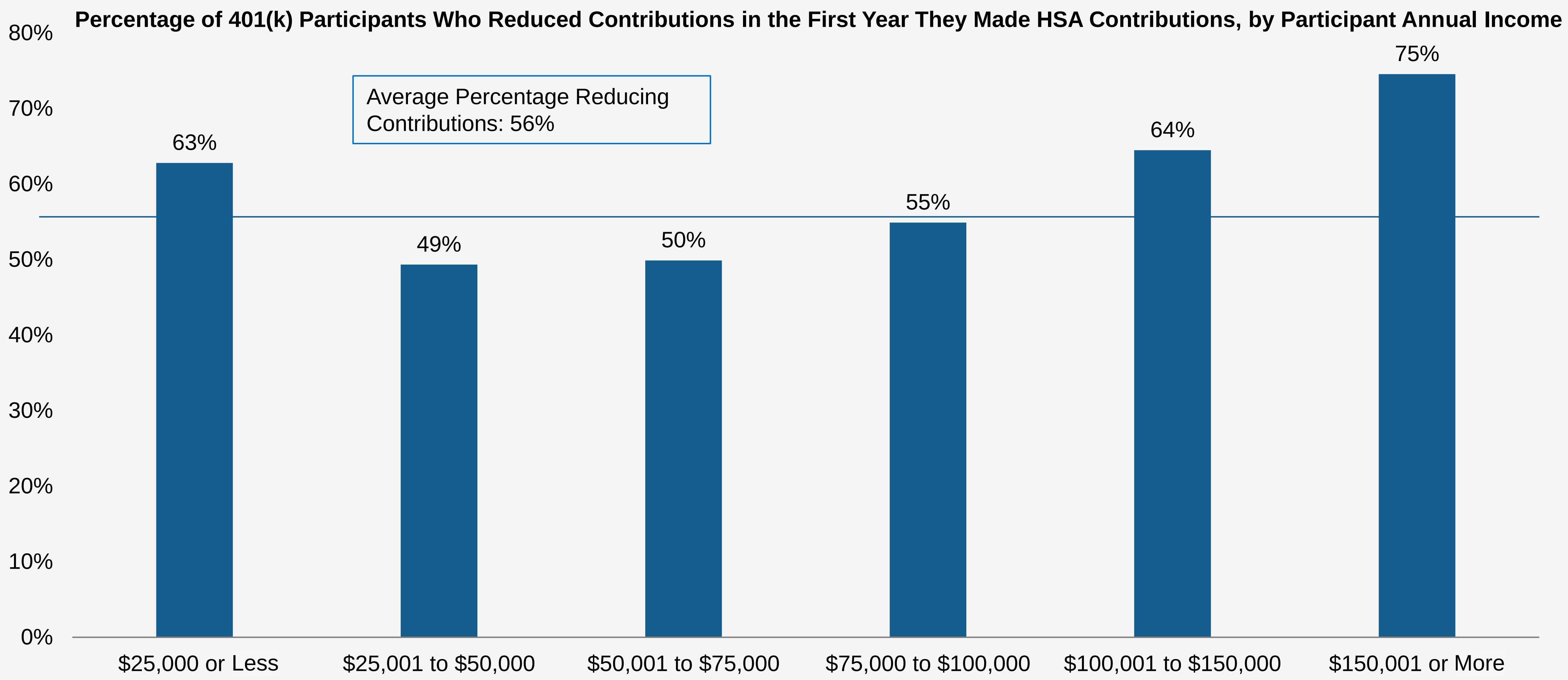
Lower- and Higher-Income Workers Most Likely to Reduce 401(k) Contributions



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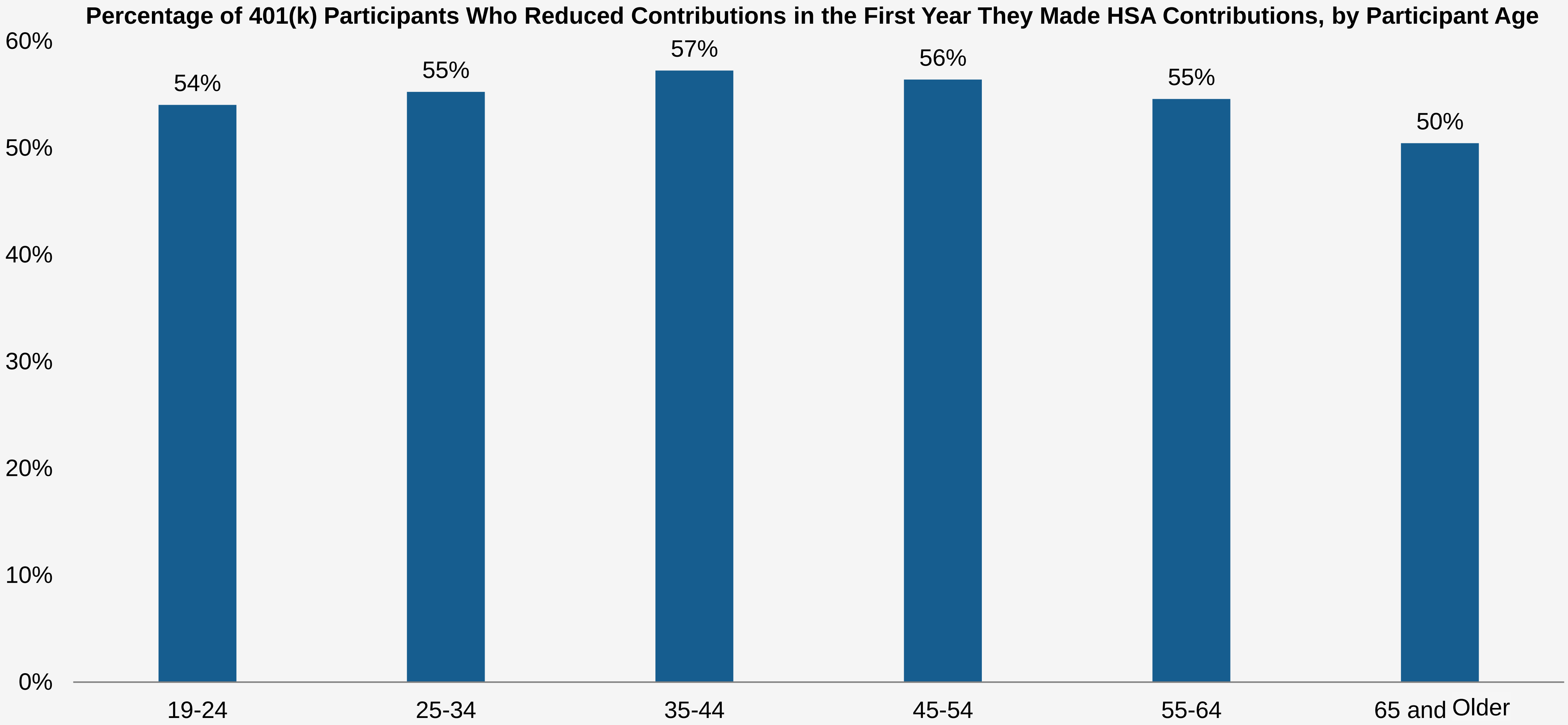
Little Variability in Reduced 401(k) Contributions by Age



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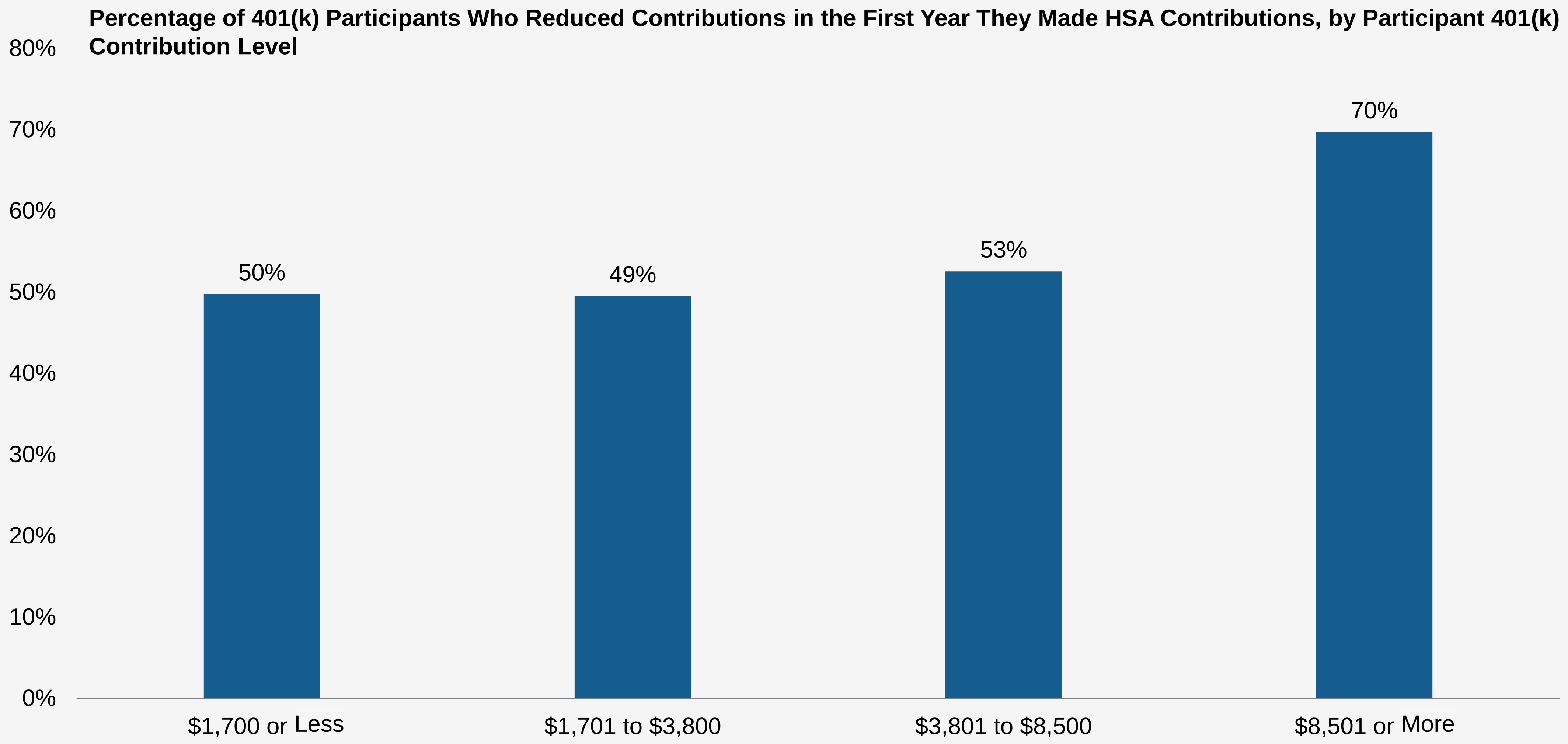
Those With Highest 401(k) Contributions in Year 1 Most Likely to Reduce 401(k) Contributions in Year 2



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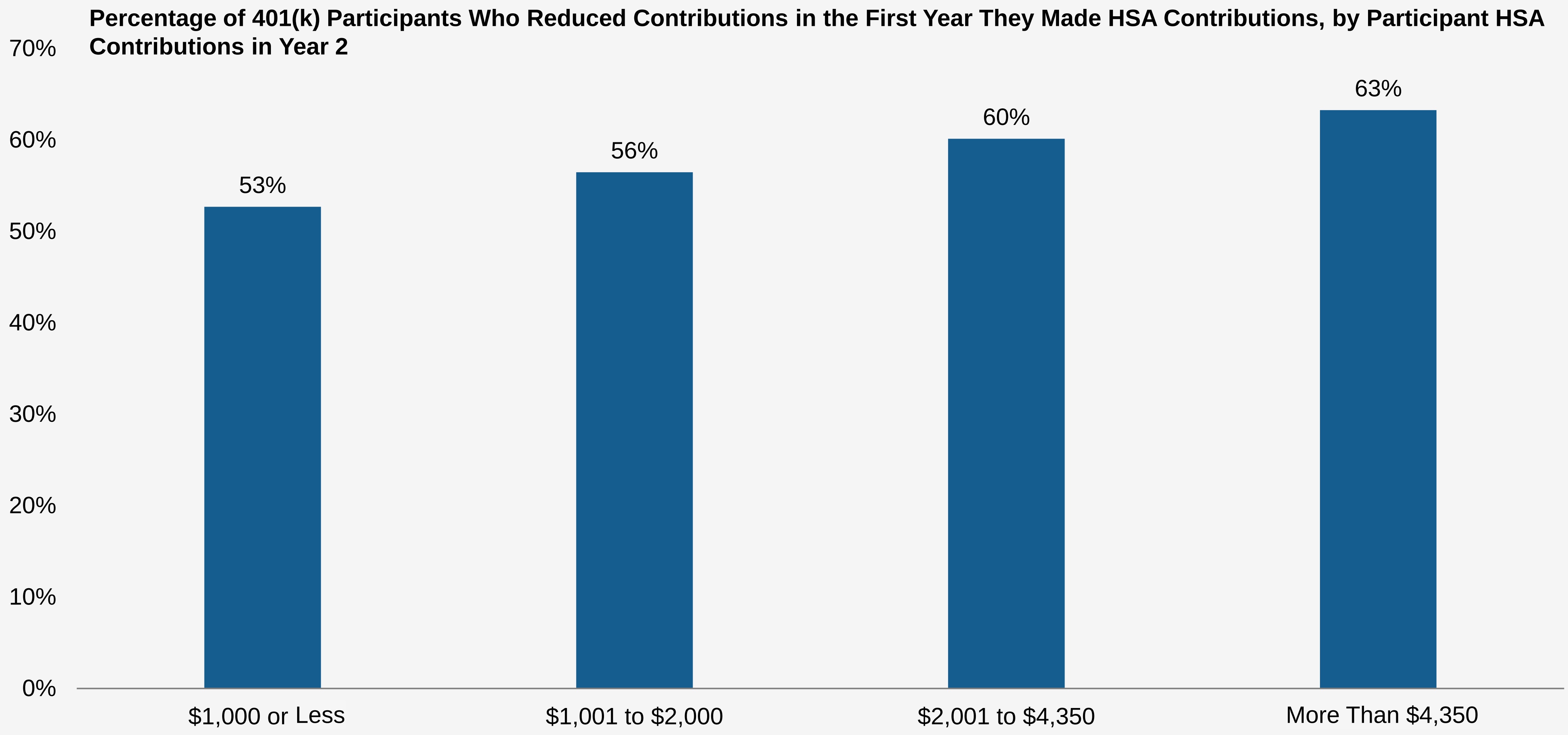
Those With the Highest HSA Contributions Are Most Likely to Reduce 401(k) Contributions in Year 2



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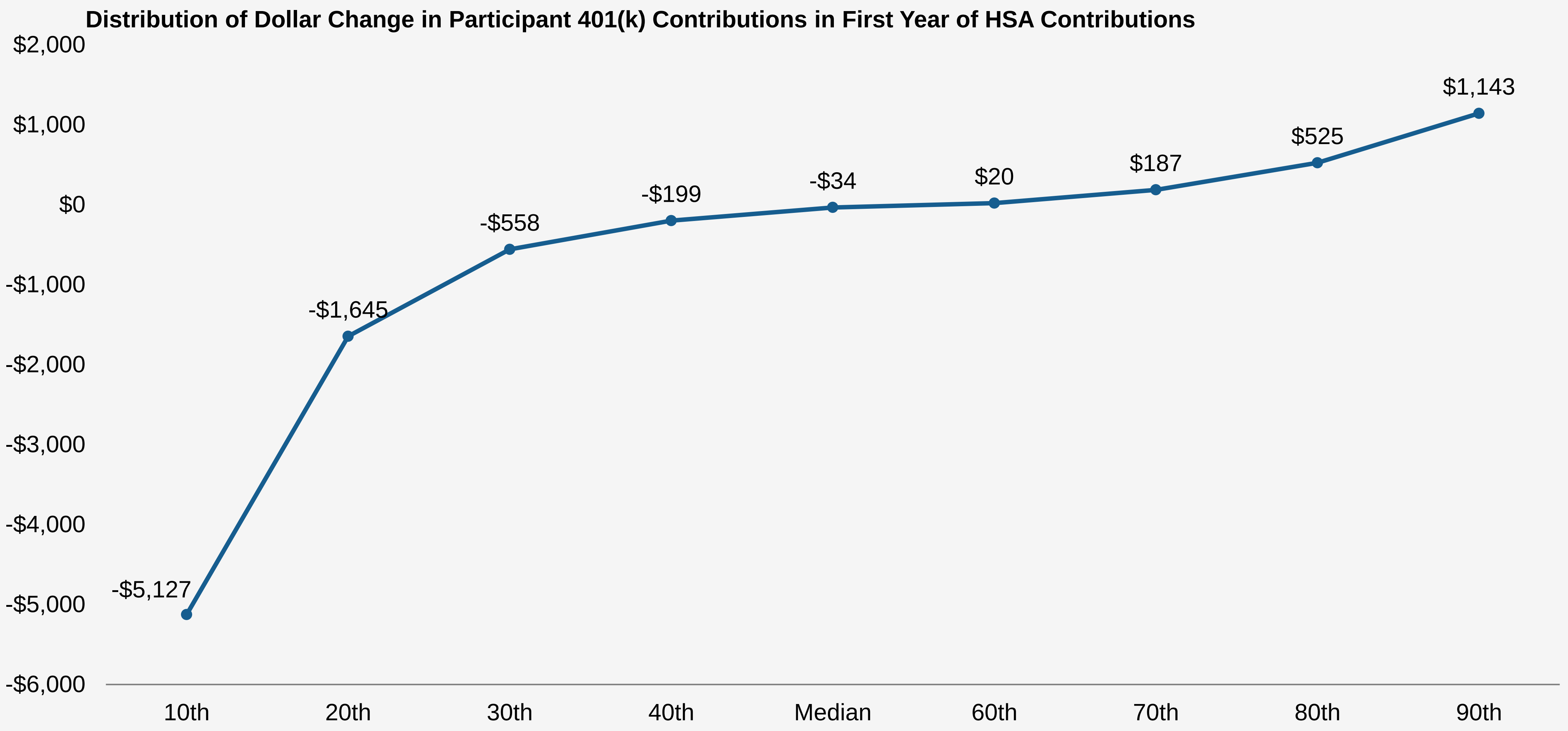
The Median Reduction in 401(k) Contributions was $34, but Ranged From Large Reductions to Large Increases



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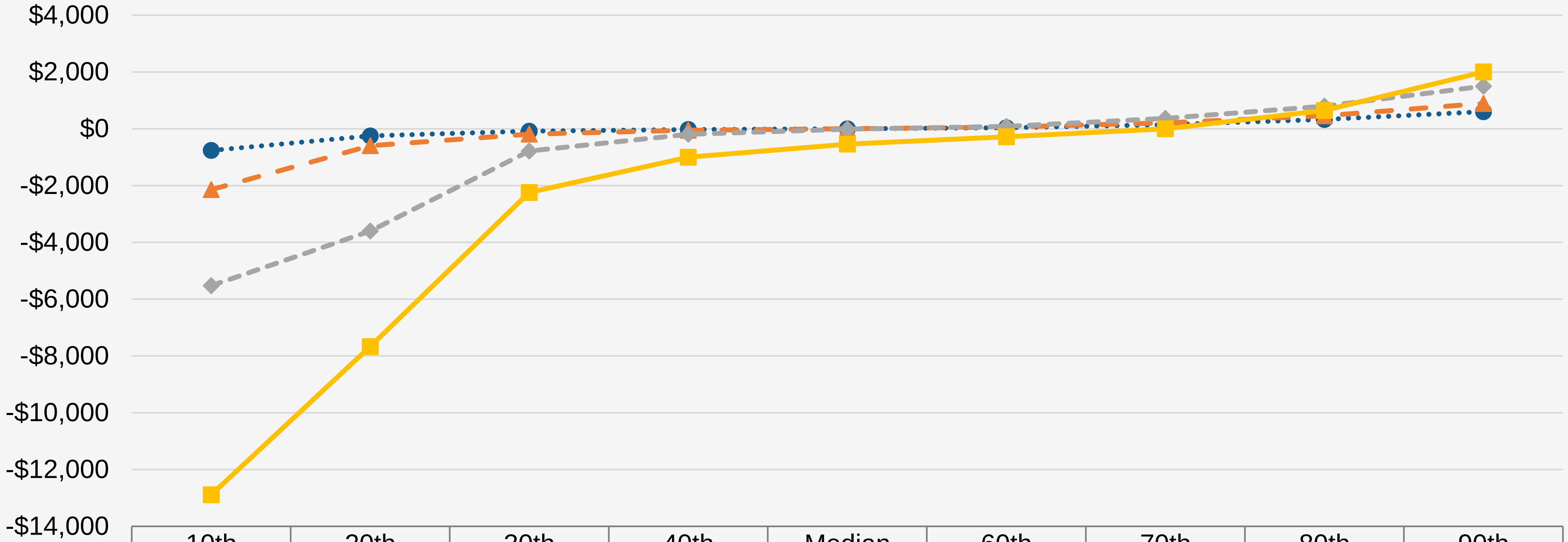
Those Making Large 401(k) Contributions Tended to Have Larger 401(k) Contribution Reductions Upon Contributing to an HSA

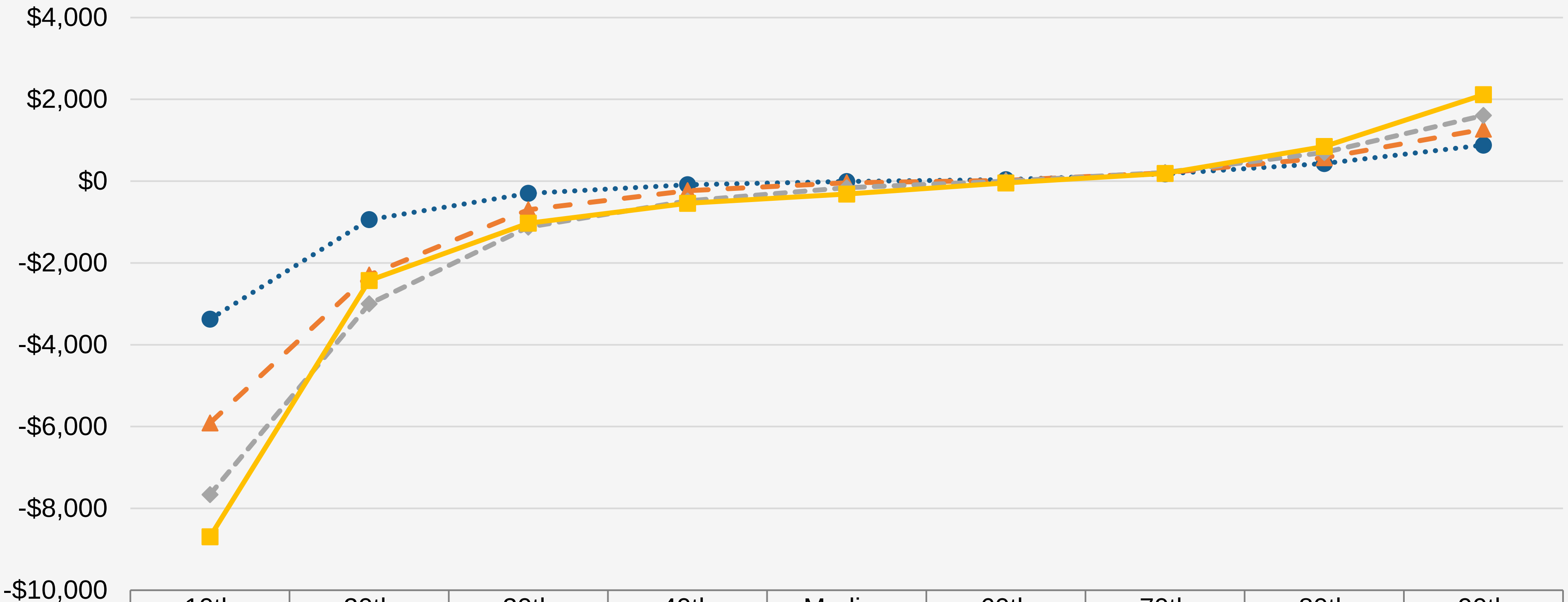
Distribution of Dollar Change in Participant 401(k) Contributions in First Year of HSA Contributions, by 401(k) Contributions in Year 1



	10th	20th	30th	40th	Median	60th	70th	80th	90th
$1,700 or Less	-$763	-$251	-$84	-$27	$0	$37	$142	$327	$600
$1,701 to $3,800	-$2,143	-$596	-$188	-$53	$1	$61	$210	$457	$892
$3,801 to $8,500	-$5,524	-$3,600	-$784	-$193	-$13	$83	$366	$798	$1,499
$8,501 or More	-$12,887	-$7,668	-$2,242	-$1,000	-$540	-$281	$1	$643	$2,002

401(k) Contributions Decreased as HSA Contributions Increased

Distribution of Dollar Change in Participant 401(k) Contributions in First Year of HSA Contributions, by HSA Contributions



	10th	20th	30th	40th	Median	60th	70th	80th	90th
$1,000 or Less	-$3,375	-$941	-$298	-$88	-$8	$37	$177	$431	$880
$1,001 to $2,000	-$5,912	-$2,293	-$698	-$233	-$39	$18	$202	$571	$1,270
$2,001 to $4,350	-$7,662	-$3,000	-$1,124	-$484	-$161	$0	$212	$700	$1,605
More Than $4,350	-$8,695	-$2,430	-$1,029	-$542	-$315	-$45	$189	$846	$2,113

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Q&A

Upcoming Events

Wednesday, June 23 — 2021 Retirement Confidence Survey: A Closer Look at Black and Hispanic Americans Webinar

Wednesday, September 22 — Financial Wellbeing Symposium*

**To Join Our Financial Wellbeing Research Center* Contact Betsy Jaffe at jaffe@ebri.org

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