# CLEARPOINT

clearstead

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## HSA: THE THIRD LEG OF THE STOOL

BY MATT KOLENICH, CPFA, AIF®, MANAGING DIRECTOR AND KRISTEN LOW, CPFA, ASSOCIATE

The "three-legged stool" is an old phrase that financial advisors once used to describe the three most common sources of retirement income: Social Security, employee pensions, and personal savings. It was expected that this trio would together provide a solid financial foundation for one's senior years. None of the three were expected to support most retirees on its own.

Over time, one leg of the stool, corporate pensions, has been replaced by employer defined contribution plans such as 401(k)'s and 403(b)'s to serve as the primary workplace retirement savings vehicle or second leg of the stool. Originally, these plans were designed to be supplementary savings accounts and serve primarily as the third leg of the stool.

What vehicle, that is currently available to millions of Americans, can serve as that third leg of the retirement savings stool today? The answer is a Health Savings Account (HSA). If you don't think of HSA's as long-term investing accounts, you're not alone. Only 12% of people who hold an HSA use it to invest in assets other than cash, according to the latest research from the Employer Benefit Research Institute (EBRI).

Health savings accounts are only available to people enrolled in high deductible health plans. For 2023, those are plans with a minimum deductible of $1,500 for individuals and $3,000 for families.

## CLEARSTEAD ADVISORS ACQUIRES SANTA FE-BASED AVALON TRUST

On March 1st, 2023, Clearstead acquired Avalon Trust ("Avalon"), a high-net-worth focused wealth management firm based in New Mexico with additional offices in Ridgewood, NJ, and Portland, OR. This acquisition reflects a continuation of Clearstead's strategy to expand its national presence, bolster its value-added services, and add seasoned executives to its platform. Avalon expands Clearstead's trust capabilities following Clearstead's acquisition of Atlantic Trust in 2021. In addition, Avalon represents Clearstead's second acquisition since Flexpoint Ford's majority investment in February 2022.

Like Clearstead, Avalon is a client-focused, growth-oriented advisory business. Avalon offers highly customized solutions across investment management, trust, family office administration, and financial planning services to individuals, families, trusts, non-profits, and foundations. The firm, including its 13 employees, is managed by industry veterans Andrew Wallerstein, Christine McDermott, and Julia Peters, all of whom will continue as senior leaders in the combined firm. The combined firm will oversee $28 billion of assets under advisement.

Additional details can be found in a press release on our website: https://www.clearstead.com/in-the-news/

# HSA: THE THIRD LEG OF THE STOOL

BY MATT KOLENICH, CPFA, AIF®, MANAGING DIRECTOR AND KRISTEN LOW, CPFA, ASSOCIATE

Monies contributed toward the HSA lowers your taxable income and can be used to cover medical expenses. In that regard, many people confuse these accounts with their cousin, the Flexible Savings Account or FSA. Unlike an FSA, which typically has a "use it or lose it" provision, the contributions to an HSA never expire. If you don't spend the money during a particular year, it will roll over indefinitely.

For 2023, the IRS contribution limits for HSAs are $3,850 for individual coverage and $7,750 for family coverage. If you're 55 or older during the tax year, you may be able to make a catch-up contribution, up to $1,000 per year. If married, your spouse, if age 55 or older, could also make a catch-up contribution, but will need to have their own HSA.

The major feature, however, of the HSA that sets it apart from other accounts is its tax benefits. Similar to pre-tax contributions in a 401(k), the contributions are tax deductible, giving tax savings in the years the contributions are made. Various retirement accounts offer some form of one or two of the following: a tax deduction on contributions, tax deferral on growth, or tax-free withdrawals. Outdoing all of these, the HSA offers the "hat trick" or triple threat of tax benefits:

- Tax deductions on contributions
- Tax deferred growth
- And tax-free withdrawals if used for qualified medical expenses

To get the most use from the tax benefits of an HSA, it is best to view it as a long-term investment vehicle to help with future medical costs in retirement. It can be a missed opportunity not to approach it as such. This would include maximizing and investing contributions for growth and paying current medical costs out of pocket, but saving the receipts so that you have the option and flexibility to withdraw funds if you find yourself in a financial bind down the road.

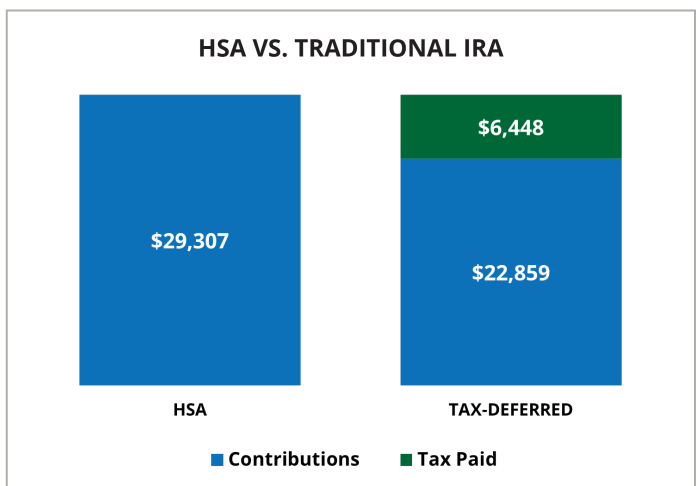
Positioning the HSA as a medical retirement plan will provide you with an important tool for navigating health care costs as you age. According to the Fidelity Retiree Health Care Cost Estimate, an average retired couple age 65 in 2022 may need approximately $315,000 saved (after-tax) to cover health care expenses in retirement.

How does the HSA compare against another savings vehicle like a traditional IRA? In this hypothetical example a person invests $3,850 in both vehicles with the same investment that earns an annualized rate of return of 7% over a 30-year time period.

Over the next 30 years, both investments grow to be worth $29,307. The difference, however, is that only $22,859 remains in the traditional IRA after paying income taxes at an effective rate of 22% upon distribution in our example.

While there is a 20% penalty if funds are withdrawn and not used for qualified medical expenses, when you retire, you can use your HSA savings for a number of qualified health care expenses, including but not limited to the following:

- IRS qualified health care premiums for Medicare Parts B, C, and D
- Medicare deductibles, co-pays, and co-insurance
- Qualified long-term care insurance premiums
- Dental and vision expense
- Over-the-counter medicine and medical equipment and supplies




Source: For illustrative purposes only. This hypothetical example assumes the following: An initial investment of $3,850 over a 30-year time period, the effective tax rate in retirement is 22%, and the investment generates an annual NET of investment and advisory fee 7% rate of return. See disclosures at the end of the article for additional information.

Once you reach age 65 and enroll in Medicare, you can no longer contribute to an HSA but that does not mean it is the end of the story. Age 65 is also when you can use HSA distributions to pay for nonmedical expenses. Those payouts aren't tax

free but are taxed at the same rate as distributions from a traditional IRA. So, if you don't need the savings for medical costs, you can use the funds to cover other retirement expenses. Unlike traditional IRA's and Defined Contribution plans, HSAs are also not subject to the required minimum distribution rules.

In summary, with all the benefits that come with an HSA, it can be a great option to cover medical expenses in retirement. Considering that you must be on a high-deductible health insurance plan to be eligible for an HSA and that such a plan may not always be available or the best fit depending on your health situation, it is important to take advantage of an HSA when you can. In return, you have the modernized third leg of the stool with triple tax benefits, flexibility to access funds for qualified medical expenses without penalty before retirement, and as a worst case scenario (after age 65), an IRA with no required minimum distributions.

**Source:**
(1) https://www.EBRI.org/health/hsa-database
(2) https://www.fidelity.com/viewpoints/personal-finance/plan-for-rising-health-care-costs
(3) https://www.irs.gov/pub/irs-drop/rp-22-24.pdf
(4) https://taxfoundation.org/2023-tax-brackets/
(5) https://www.irs.gov/pub/irs-pdf/p969.pdf

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*Performance data shown represents past performance. Past performance is not an indicator of future results. Current performance data may be lower or higher than the performance data presented. The annualized rate of return used in the HSA vs. IRA growth example of 7% is hypothetical and does NOT represent actual or expected returns. The hypothetical rate of return is shown for informational purposes only and Clearstead is making no representation that this rate of return can or will be achieved. The rate of return represents a NET of investment manager and/or advisory fees return which means that the rate of return would have to be higher before these fees were deducted. For example, if the NET of fees rate of return is 7% then the GROSS of fees rate of return would most likely need to be 8% or higher, depending on these fees, which could be 1% or higher.*

MARKET BENCHMARK RETURNS

| February 28, 2023 | | 1M | 3M | 12M | YTD |
|---|---|---|---|---|---|
| US Large Cap | S&P 500 | -3.0% | -3.9% | 16.4% | -8.0% |
| US Small Cap | Russell 2000 | 1.1% | -6.6% | -6.0% | -8.7% |
| Developed Intl | MSCI EAFE | -1.8% | -1.7% | 2.8% | -6.5% |
| Emerging Intl | MSCI Em Mkt | -3.0% | -3.0% | -10.7% | -4.8% |
| Real Estate | NAREIT | -3.9% | -3.2% | 20.6% | -11.3% |
| Core Fixed | BarCap Agg | -1.1% | -3.5% | -2.6% | -3.2% |
| Short Fixed | BarCap 1-3Yr | -0.4% | -1.3% | -1.6% | -1.1% |
| Long Fixed | BarCap LT G/C | -2.5% | -8.1% | -2.8% | -7.3% |
| Corp Debt | BarCap Corp | -1.9% | -5.1% | -3.3% | -5.0% |

Source: Bloomberg

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