Why an HSA Is a Better Retirement Savings Vehicle Than a 401(k)

For some of you it can seem like a long way off, but healthcare expenses in retirement are no joke. Healthcare costs impact everyone in the U.S., and I always try to consider it "in macro," but recently it hit close to home for me, when my 74-year-old father had to make a hard choice between his heart and his teeth. Let me explain.

Not long ago, I found myself sitting in a dentist's office with my dad because he was having some serious problems with his teeth. The dentist came in and told him, "I don't know how else to put this, but your best bet right now is for us to pull all of your teeth and get you in dentures."

The dentist could tell I was in shock. He turned to my dad, who has had relatively good retiree benefits from his successful 42-year career as an engineer, and asked him how things had gotten so out of hand. He said, "You know, for the last six or seven years, I have had to make some tough financial choices between my heart medications, which are very expensive, and my teeth."

This was all overwhelming, and certainly brought all of those macro-economic facts about retiree medical costs right to my own family's very personal life.

When most of us think about planning for retirement, we are usually imagining where we will live. Will we spend our days in Florida or at a cabin in the north woods? Better yet, let's do both.

Choosing between your teeth and your heart is not the kind of thing you think about when you plan for retirement. And though Medicare helps pay for the healthcare needs of 59 million people, the average recipient still spends thousands a year on out-of-pocket expenses. By 2030, it's estimated that out-of-pocket healthcare costs for Medicare beneficiaries are likely to take up half of their average social security income. That's a huge figure for a program that was originally built to pay for all health costs in retirement.

In my work with consumer-directed healthcare plans at WEX Health, I do a lot of thinking about how Americans can thrive in their golden years, and I've long been aware that the future, for many aging Americans, is going to be full of these sorts of touch choices. But this experience with my dad reinforced for me that many people are not on a solid financial track, and reminded me why I want to be part of helping Americans to achieve greater financial health—now and in retirement.

According to Census Bureau data, the typical household that earns less than $67,200 a year has no retirement savings. And across all income levels, at least 50 percent of Americans are at risk of not having enough money to maintain their living standards in retirement. Much of this can be attributed to the cost of healthcare during retirement years: The average 65-year-old couple retiring today will need $280,000 to cover healthcare and medical costs in retirement. Very, very few people have that kind of money, or ever will.

One of the best solutions to the problem of saving this sum of money is right in front of our faces: the health savings account (HSA). The triple-tax benefit of these accounts is that contributions are not subject to federal income taxes; earnings from interest and investments are tax-free; and distributions from an HSA to pay for qualified medical expenses are tax-free.

Yet, when I meet with teams of brokers and financial advisors, they're too often surprised by how appealing HSAs are from a retirement health savings angle. Because many of them are behind in their own knowledge of HSAs, they're not educating their customers about them and are still steering their clients toward 401(k) plans and IRAs rather than HSAs. However, the retirement community is being slowly awakened to the merits of an HSA. We're starting to see a lot of companies that offer retirement solutions getting in the game.

That's because more people are realizing that a HSA is superior to a 401(k) when it comes to saving for retirement. It has all the same advantages of a 401(k), but it additionally allows people to take their money out tax free to pay for healthcare costs in the future or in the past. Which means that I can contribute money (pre-tax!) to my HSA up to the point I am on Medicare, and then use that money at any point for healthcare expenses, and unlike a 401(k), I'll pay no taxes on the withdrawals. If for some reason I do not need that money for healthcare, I can still withdraw it for non-healthcare expenses and pay income taxes on it exactly like my 401(k). In other words, after age 65, if I decide to use my HSA money to take a vacation instead of for healthcare, I am no worse off than if I used my 401(k) dollars to do it.

Saving for a retirement home on the beach is a lot more fun than saving for healthcare costs. Everyone agrees that having your health is the most important thing, but no one wants to pay for healthcare, much less save for it.

The fact is that you do have some control over your lifestyle in retirement, but you can't predict what your healthcare expenses are going to be. Even the most frugal among us aren't planning to adjust their lifestyle to satisfy their healthcare costs. So I encourage people, when thinking about saving for retirement, to consider setting aside some dollars you'd prefer to spend on something today for fun, and instead invest them in an HSA. Someday you, and maybe your son or daughter, will be very glad you did.