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Why Health Savings Accounts Cannot Cover All Retiree Medical Costs

WASHINGTON—How far will health savings accounts (HSAs) take individuals toward reaching the amount they will need to cover medical expenses in retirement?

HSAs are often touted as a vehicle for funding future retiree health care costs. However, a recent study by the nonpartisan Employee Benefit Research Institute (EBRI) reported that statutory contribution limits mean that HSAs are unlikely to play more than a minor part in savings for retiree health care costs.

For example, if an individual age 55 in 2009 were to contribute \$3,000 to his or her HSA and also contribute the \$1,000 catch-up contribution each year for 10 years, after 10 years a total of \$46,200 could be accumulated if interest rates were 1 percent over the 10-year period and no withdrawals were taken from the account. If interest rates were 5 percent, \$55,100 would be accumulated at the end of 10 years (right hand column in figure below).

According to EBRI estimates, a man age 55 in 2009 would need between \$144,000 and \$290,000 by the time he reached age 65 in 2019 (depending upon his use of prescription drugs in retirement) to have a 50 percent chance of having enough money to cover premiums and out-of-pocket expenses for Medigap and Medicare Part D. Thus, a 55-year-old man would be able to use an HSA to save between 16 percent and 32 percent of needed savings for insurance premiums and out-of-pocket expenses in retirement if he was comfortable with a 50–50 chance of having enough savings and the account earned only 1 percent interest during the next 10 years. If a 2 percent interest rate is assumed, between 17 percent and 34 percent of necessary savings would be accumulated in the HSA. Because women, on average, live longer, they will need greater savings.

Potential Savings in an HSA* After 10 Years of Contributions for a 55-Year-Old Individual, by Percentage of Account Rolled Over Each Year and Interest Rate**

	50% Rollover at Year-end	75% Rollover at Year-end	90% Rollover at Year-end	100% Rollover at Year-end
1% Interest Rate	\$9,700	\$18,000	\$30,500	\$46,200
2% Interest Rate	\$9,900	\$18,600	\$31,700	\$48,300
5% Interest Rate	\$10,500	\$20,500	\$35,800	\$55,100

Source: Estimates by the Employee Benefit Research Institute.

*HSA = Health savings account.

** Individual rolls over various percentages of end-of-year account balances and makes maximum catch-up contributions. Contributions also are indexed for inflation.

Details of the study appear in the April *EBRI Notes*, available at www.ebri.org/pdf/notespdf/EBRI_Notes_04-Apr10.HSAs-TaxExpends1.pdf

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