Good, But Not Great?

While health savings accounts have many virtues, what financial planners don't know about them can be costly to clients. By Donald Jay Korn

HEALTH SAVINGS ACCOUNTS (HSAs) have many supporters among financial planners. "HSAs can be better than a Roth IRA," says Helen Huntley of Holifield Huntley Financial Advisers in St. Petersburg, Fla. "Tax-deductible contributions and tax-free withdrawals are a pretty unbeatable combination."

An HSA pairs a high-deductible insurance plan with a tax-free savings account that the insured can use for health expenses now, or save or invest for a later date or retirement. As Huntley mentioned, it offers big tax savings: The money contributed to the account is tax deductible, it grows tax-free and certain withdrawals are tax-free if they are for qualified medical expenses. This year's maximum tax-deductible contributions are $3,050 for individuals, $6,150 for families and $7,150 for people 55 or older buying family coverage.

Although HSAs were barely mentioned during last year's health insurance discussion, they appear to be gaining in popularity. In February 2010, JPMorgan Chase reported that its HSA business had grown by 30% over the past year, adding more than 115,000 accounts and $220 million in deposits. "I believe we are on par with or a little bit ahead of the industry," says David Josephs, a managing director who oversees the Chase HSA.

At Chase, a great deal of the growth came via HSAs offered through employers. But individuals have been switching to HSAs too.

The majority of buyers are choosing high-deductible policies that qualify for HSAs, according to eHealthInsurance and HSA for America, two firms that focus on individual and family health coverage. "Premiums are lower than for traditional health insurance," says Sam Gibbs, senior vice president of sales at eHealthInsurance Services in Mountain View, Calif. "Some of our new business comes from people who have lost jobs and find these arrangements are better than continuing coverage under COBRA, which can be very expensive."

Growth can cause growing pains, though, and HSAs are no exception. They are complicated products, and planners who suggest them to clients should consider the following issues before making any recommendations.

RIGHT CLIENT?

"The biggest drawback to HSAs is educating clients about them," says Kathleen Campbell, a financial planner in Fort Myers, Fla. "It's hard to get clients to understand the ins and outs of HSAs, and why they would to effectively leverage his capabilities during and after the transition. For example, instead of running the firm outright, McDonald now takes on the role of "sounding board, thought leader and figurehead." By maintaining contact with the firm and an agreed-upon level of activity, he'll still be around to see the firm grow.

A NEW CAREER

Sam Hull, who owns the life and business coaching firm Whitewater Transitions in Arundel, Maine, realized one day that he had hit a wall in his financial planning practice.

"At one point, I loved financial planning," Hull said. "But after the thousandth financial plan, it didn't give me a thrill—and I was getting bored. I wasn't really being of service to the client."

If you don't have complete confidence in the people you're leaving in charge, you're not going to want to let go of the reins.

By all measures, Hull had done well with his practice, established in 1992 in Kennebunkport, Maine. Over time, though, he discovered that he instead "got his kicks" doing life planning. After consulting with George Kinder, widely recognized as the father of financial life planning (and this month's *FP* Influencer), he began a plan to sell his business.

Before he tackled the financial details, Hull set down some ground rules for the transition in an "intentionality statement." He knew that it would be difficult to let go of the business and his clients emotionally, so he plumbed his psyche to ask the questions "Who am I and what's my meaning in the world?" Those engaged in Kinder's training would recognize this familiar query, one designed to prepare the individual for the road ahead.

"Once you have a feeling as to what you're all about," Hull adds, "recognize that you will be going through a powerful transitional period while you're selling your business. Before charging ahead, it's important to recognize that there are three distinct phases involved in any transition: First you must let go of the past while honoring what you're giving up, then you must give yourself permission to take time out. Only then can you move into the next phase of your life."

THE NUTS AND BOLTS

The financial side of the transition involved valuing the business, figuring out how to manage the tax consequences of the sale of what was his largest single asset and ensuring that his personal financial future would be secure. That meant setting aside enough cash to pay ongoing household expenses and even downscaling some goals.

He and his wife, for example, had always dreamed of buying a home on the coast of Maine. The expense proved prohibitive, so they settled for a place a few miles inland on a river. Other lifestyle decisions included buying a car every eight years instead of every three.

In 2003, Hull found a well-trained CFP who was willing to become his successor at the firm. Together they structured a buyout that concluded in April 2008.

"Build your (cash) cushion," Hull advises those considering a transition. "It takes about three or four years to reach profitability."

On the personal side, Hull says you have to pay attention to details in your own comprehensive financial plan and cash flow. If debt or other personal finances become a distraction during the process, "take the time to clean them up before you start."

Hull says you'll also need to examine tax implications and issues with your staff, update your personal financial plan and talk it over with your family. If your business provided you with perks that you'd like to continue —cellphone, golf membership, cars, for example—you can include that in your plan.

As with McDonald, Hull's transition wasn't seamless. Taking a hit along with the rest of the industry in 2008, he had to "dial back" his plans to start his new business. His wife also needed to work a little longer at her job. That's why building up a significant cash reserve to cover any unforeseen circumstances is always a good idea.

No matter how you approach a transition, keep in mind that it's something that evolves over time. For most practitioners, the cold-turkey approach won't be successful because of the myriad tax, planning and personal issues you need to thoroughly account for.

Your financial plan will need to address how you're going to maintain income and lifestyle during and after the transition. And don't forget a life plan "that will need to focus on the next phase of your life and what values will give meaning to yourself, your family and the world around you," Hull adds.

Moving on involves the same creativity that you tapped into when you created your practice. As McDonald says, "If you can dream it, you can see it; if you can see it, you can do it." FP

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benefit from them."

In order to open an HSA, a client must have a health insurance policy that meets certain requirements, including a high deductible. The high deductible decreases the premium, but increases the client's exposure to out-of-pocket costs. According to eHealthInsurance, the average monthly premium for its HSA-eligible insurance is $143 for individual coverage, which pays for a policy with a deductible of $3,382. For family coverage, the average premium is $331 a month, which pays for a policy with a deductible of $5,612, on average. Such coverage might be right for some clients but not others.

"We have used HSAs with several companies where the plans didn't work," says Doug Neal, a planner in Houston. "Those clients' companies had many employees with families. Young children go to the doctor all the time, and the HSA was depleted very early in the year. The families were not used to having to pay the full freight." Neal adds that one company had employees all over Texas, which made it hard to use the network.

Neal is much more upbeat about his firm's experience. "Our HSA plan works well, because most of our people are in their fifties or sixties, with kids who are grown," he says. "The usual expense is the annual physical. We save approximately $250 per month per person on medical costs."

Richard Imbrey, a financial planner in Knoxville, Tenn., says HSAs have been successful for most of his clients, but there have been some startup concerns. Imbrey generally recommends that clients make large deposits into the HSA account in the first year, so that the account has enough funds in it to cover reimbursements: "If an account doesn't have enough to cover a deductible, you can still deposit a lump sum into it up to the maximum limit so that the claims are paid with pretax dollars. But it's easier to fund the accounts on a monthly basis." Imbrey adds that if the plan offers a debit card clients can use for co-pays at the doctors' office, it simplifies reimbursements from the HSA.

RIGHT PROVIDER?

If coverage is offered at work, the employer often suggests one or more HSA providers. "Some employers have undesirable choices for the HSAs they offer their employees," says Connie Stone, president of Stepping Stone Financial in Chagrin Falls, Ohio. "They usually have a bank option that pays very little and mutual funds that may have high expenses." Stone prefers several good options, so some money can be kept liquid in case an employee needs to pay medical expenses now, and the rest can accumulate returns in mutual funds for later use.

Fortunately, a lack of good HSA choices often can be remedied. "Many people think they must use the HSA provider that's recommended by the insurance company," says Fred Adams, co-founder of insurance agency HSA for America in Athens, Ga. "You can change HSA providers, if you wish. Usually, it's better to let the new provider handle the paperwork for the transfer. If you try to withdraw money from your current provider, you might encounter delays."

Campbell says that it's not difficult to find a low-expense HSA provider and set up an account there. "The insurance company issuing the HSA policy usually has a custodian in-house or one it recommends, but the policyholder can generally choose his or her own custodian," he says.

RIGHT FEES?

A search for a low-fee HSA provider might pay off. "Look at setup fees, ongoing fees, check fees, debit card fees and investment transaction fees," says Lauren Lindsay, director of financial planning at Personal Financial Advisors in Covington, La. If your client wants to invest in mutual funds, Lindsay advises finding out whether he is putting the money in A shares, which usually levy transaction fees.

David Childs, financial planning manager at Stearns Financial Services Group in Greensboro, N.C., says that HSA fees can be in the $1 to $3 per month range just to maintain an account with a bank. There can be additional fees for ATM transactions and even more fees if clients want to invest their HSA balance instead of leaving it in a traditional savings account. "Even with those fees, the client typically still will come out ahead by switching to an HSA and fully funding it annually," Childs says.

HSA fees are by no means constant across the industry. "I have found that it really pays to shop around," Huntley says. "Some HSA providers will waive their fees if you sign up for electronic statements."

Huntley uses a local bank, Freedom Bank, which recently was paying 3% on balances above $1,000. She also notes that a company called Health Savings Administrators provides the ability to use Vanguard funds in your HSA. There's a $20 setup fee, a $39 annual fee and a small fee per mutual fund chosen. "If you had $10,000 in your HSA and you wanted an equity investment, I think this might be a good way to go," Huntley says.

Other advisors agree that putting HSA money into equities makes sense. "Bank interest rates are not high enough to justify the fees of an

Clients should make a large deposit into the HSA in the first year, so the account has enough funds in it to cover reimbursements.

HSA," says Sean Sebold, a financial planner in Naperville, Ill. "However, HSAs can be worthwhile, counting the tax savings, if you are investing the money in equities. Our strategy is to have higher-net-worth clients fully fund an HSA and pay for all medical expenses out of pocket while the HSA investments grow." Millennium Trust Co. in Oak Brook, Ill., has a fee schedule for HSAs that is relatively low if you are investing in equities and you have built up an account over $10,000, Sebold adds.

The hunt for low fees can require some effort. Chase, for example, reports that its monthly HSA account maintenance fee is $2.50. There are no transaction fees for using the card to make withdrawals at an ATM, using the card to pay for expenses at point-of-sale or paying bills online. For the Chase HSA Investment Account, there are no fees if trades are made online. Monthly account statements can be accessed online at no charge, and the first two additional cards for the account are free. Fees are charged in some cases, such as when there are insufficient funds in the account or to replace a lost or stolen card.

Nevertheless, there are situations where a Chase HSA client has to put up with seemingly endless fees. One account owner via a group plan says she has to pay a charge if she writes a check or withdraws funds from her HSA at a cash machine, perhaps to reimburse herself for a co-pay. Check writing and ATM use has become more frequent because Chase will not provide a debit card for a third family member—a college student. She also says that she must pay a charge for depositing funds from another account to her HSA, if she wants to add to her balance, and she doesn't understand why this should be the case.

When asked about these comments, a Chase spokesman responded, "Chase does not set the fee schedule for HSAs sold via our insurance company partners. Thus we are unable to comment on whether certain partners charge fees for ATM withdrawals, fund deposits or additional cards." Apparently, planners looking into HSAs for clients should check out the fee schedules set by insurers as well as those of the providers.

RIGHT RECORDS?

Planners should alert clients to monitor HSAs carefully. Stone frequently struggles with his HSA provider's annual reporting of employer versus employee contributions, which is often inaccurate. "Some months they're posted as employee and other months as employer contributions. Every year I call to get it corrected, to no avail," he says.

Campbell concurs that diligent recordkeeping is necessary with an HSA. "Account holders should keep track of all their eligible expenses and handle their own reimbursements," she says. "I record a year's worth of my own HSA expenses and reimburse myself from the HSA account all at once. I keep HSA receipts separate because they could be subject to an IRS audit at some point." Campbell often finds that account owners are not getting the full benefits because they don't closely track expenses.

Poor recordkeeping also may have adverse tax effects. Jessica Hovis, a planner with Longview Financial Advisors in Huntsville, Ala., worries about the lack of detailed end-of-year reporting. "My contributions into the HSA have been a combination of payroll withholding and direct after-tax contributions; however, this is not noted on any end-of-year tax notices."

For 2009, the Form 1099 that Hovis received stated the amount of her HSA contribution without indicating this split between payroll withholding (untaxed dollars) and direct contributions (deductible dollars). "I'm afraid this lack of disclosure could lead to HSA owners inadvertently taking a higher deduction than permitted," she says.

Payroll withholding may be better than direct contributions for clients, Childs contends. "Employees can avoid FICA taxes on the amount contributed to the HSA, which saves money for the employer and the employee," he says.

One kink Childs found is that it is up to the human resources representative at the firm to decide where HSA funds contributed through payroll deductions ultimately end up. For example, if John Smith asked to contribute $100 a month through payroll withholding, the company could force those contributions to go to its preferred HSA provider. Once those funds arrived at the company's recommended HSA provider, however, John could request a transfer to the HSA provider of his choice.

If John wanted to make contributions outside of payroll withholding, he could choose any provider he wanted and make the contribution sdirectly. However, those dollars would not be exempt from FICA taxes.

Generally, HSAs offer triple tax breaks: tax-deductible contributions, tax-deferred earnings and tax-free withdrawals for qualified medical expenses. Planners may be able to point clients to more tax relief, if HSAs can be funded with money that avoids payroll taxes. FP

Planner Sean Sebold suggests HNW clients fully fund an HSA and pay all medical expenses out of pocket while HSA investments grow.

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