Modern retirement monthly

Open enrollment: A checklist for 2020 benefits

Chief Investment Office GWM | 08 November 2019 3:51 pm GMT
Ainsley Carbone, Total Wealth Strategist Americas, ainsley.carbone@ubs.com; **Justin Waring**, Investment Strategist Americas, justin.waring@ubs.com

- Every year, employees are given an opportunity to re-affirm or update their benefits. These decisions should not be taken for granted, and making a change from last year's elections may make sense in the context of your financial plan.
- In this report, we run through a checklist of decisions, including health insurance, retirement plan contributions, and life insurance elections.
- For investors who are eligible for a Health Savings Account (HSA), we recommend taking advantage of this triple tax-advantaged investment vehicle.
- Opting for lowest-cost benefits may increase your paycheck today, but it might hurt your overall wealth in the long run.
- We recommend weighing both cost- and coverage-related aspects when choosing a health plan, and consider all open enrollment decisions in the context of your financial plan.

When selecting workplace benefits, many individuals have difficulty determining which benefits they need and how much. Answers to these questions vary from one family to the next, but approaching these decisions through the lens of your financial plan can help simplify the process. But, before determining what's right for you, it's important to have an understanding of how each benefit works along with how they can impact you today and in the future.

Health insurance

When shopping for health insurance, it's difficult to look past the "sticker price." Although there is an obvious difference in the monthly premium amounts associated with low- and high-deductible health plans (HDHPs), the lowest-premium plan isn't necessarily the least expensive overall. Having a "high deductible" means that your paycheck will be a bit larger, due to the lower monthly premiums, but you'll also need to shell out a greater dollar amount before your plan begins sharing out-of-pocket costs with you.

Low-deductible health plans

These plans sometimes offer Flexible Spending Accounts (FSAs) to help pay out-of-pocket expenses. Money is contributed to an FSA pre-tax and distributions are made tax-free when used to cover qualified expenses. But, FSAs work on a "use it or lose it" basis, meaning any funds not spent by the end of the year will be lost, unless the plan has a grace period or rollover feature.

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High-deductible health plans (HDHPs)
Although HDHPs can leave workers exposed to higher costs for normal non-catastrophic illnesses,they often come with lower premiums. As a result, they may be a good option for younger and healthier workers who have fewer ongoing health expenses.

HDHPs may offer FSAs (with some limitations), but they also offer access to a unique and often under-appreciated benefit:Health Savings Accounts (HSAs). Unlike FSAs, HSA savings are not subject to a "use it or lose it" time horizon.

In fact, HSAs are one of the best investment vehicles available to investors, because they are triple tax-advantaged: no tax on contributions, growth, or distributions (as long as the funds are spent on qualified medical costs).These features make HSAs the most tax-friendly investment vehicle available, and removing this tax drag can mean thousands of dollars of tax savings on healthcare costs.

In fact, our analysis finds that—even though annual HSA contribution limits are lower than 401(k) limits—maximizing HSA contributions each year (and investing in a growth-oriented strategy) might give many families enough to cover the bulk of their out-of-pocket healthcare expenses in retirement. Please see Open enrollment and tax-free growth and HSA Q&A for details and answers to frequently asked questions.

Retirement accounts

If you're lucky enough to work for a company that has an employer-sponsored retirement plan like a 401(k), make sure you take advantage. There's a reason why many Americans hold the bulk of their investment savings in a 401(k) account: They provide an opportunity for tax-deferred growth that compounds over time, and in many cases your employer may match a share of your contributions, so failing to participate means taking a voluntary pay cut.

It's important to enroll in this benefit as early in your career as feasible, and to strive to maximize your contributions to take full advantage of tax-deferred growth over the course of your lifetime. The earlier you start, and the more you add, the more taxes you will save and the more investment growth is possible.

When choosing how much of your contributions to allocate to your Traditional or Roth 401(k) account, bear in mind that you may want to make changes to last year's elections. If you've moved to a higher-tax state, if you've been bumped into a higher income tax bracket, or if you're simply worried that taxes will be higher in the future, then adding tax diversification by spreading assets between tax-deferred and tax-exempt retirement accounts can help you manage risks around your tax liability.

Even if you don't have access to a 401(k), you may be eligible to contribute to a Traditional or Roth IRA. While direct IRA contributions don't usually enjoy the benefit of employer-matched contributions, they still offer the same tax-exempt or tax-deferred earnings growth as their 401(k) counterparts (see Table 1).

HSAs offer a triple tax advantage

1. **Pre-tax** contributions, similar to a Traditional IRA or 401(k) contribution.
2. **Tax-free** investment earnings.
3. **Tax-free** distributions used to cover qualified medical expenses.

Table 1: Tax treatments on retirement accounts
Depending on the type of account, assets will be taxed differently when contributing to them and distributing from them. And each account has different restrictions, limitations, and provisions. Investors should consider each account's stipulations before incorporating them into the financial plan.

		Tax treatment					
		Contributions are pre-tax	Investment earnings grow tax-free	Qualified distributions are tax-free	Income restrictions	Contribution limits (2020)	Required Minimum Distributions (RMDs)
Tax-deferred	Traditional 401(k)	X	X		No	$19,500 ($26,000 if age 50+)	Yes
Tax-deferred	Traditional IRA	X	X		Deduction is phased-out completely if MAGI is at least $75,000 (single) or $124,000 (married filing jointly)*	$6,000 ($7,000 if age 50+)	Yes
Tax-exempt	Roth 401(k)		X	X	No	$19,500 ($26,000 if age 50+)	Yes
Tax-exempt	Roth IRA		X	X	Ability to contribute is totally phased out if MAGI is at least $139,000 (single) or $206,000 (married filing jointly)	$6,000 ($7,000 if age 50+)	No
Tax-exempt	Health Savings Account (HSA)**	X	X	X	No	- Individual: $3,550 ($4,550 if age 55+) - Family: $7,100 ($9,100 if both spouses are age 55+)	No

*If neither you nor spouse is eligible for a 401(k), the contribution is 100% deductible, regardless of modified adjusted gross income (MAGI).

**Must be enrolled in a High Deductible Health Plan (HDHP) for eligibility.

Source: IRS, UBS

Other insurance coverage

In addition to health and retirement plans, your employer may offer other benefits like disability and life insurance. Some employers offering these policies may even pay some or all of the cost of the premiums for you.

While the low or no cost of this benefit is an enticing feature, it's important to be aware of what you're actually getting out of the policy. Some policies cover just a portion of your base salary when benefits are actually needed and there may even be a cap on that amount. What's more, depending on who pays the premiums for your coverage (you or your employer), your benefits will be taxed differently if and when they're paid out.

Before defaulting to whichever option costs the least amount today, it's important to understand the details of your coverage to ensure the right amount of protection for you and your family.

Q&A: Open enrollment and your financial plan

With a basic understanding of your benefits, you'll have an easier time determining which options are right for you within the context of your financial plan. Here are some important financial plan implications to consider when making your open enrollment decisions.

Should I use an FSA or an HSA?
It might make sense to contribute to both, since they serve different purposes; FSA savings must be earmarked for near-term spending, while HSA assets are best invested for long-term growth.

If you're looking for an account to help you cover current healthcare costs, FSAs' "use it or lose it" rule makes them an ideal source of funds, and thus considered a part of the Liquidity strategy (funds for meeting the next three to five years of cash flow needs—in this case, out-of-pocket healthcare expenses).

FSA contribution amounts are typically locked-in after the enrollment period, so it's important to take the time to estimate next year's out-of-pocket expenses before setting up your account. If you underestimate expenses and underfund the account, you'll need to use after-tax dollars when the FSA is depleted. However, if you overfund the account, you'll find yourself trying to load up on qualified expenditures near the end of the year in order to avoid forfeiting excess assets.

HSAs, on the other hand, are much better suited for the Longevity strategy—assets earmarked for retirement spending—because of their significant tax-advantaged growth potential, and the importance of funding healthcare expenses in retirement. While investors do have the option of using HSA assets during their working years, we generally recommend using after-tax dollars or FSA assets instead, to make the most of HSA assets' triple tax advantaged compound growth.

If you do not have after-tax or FSA resources to tap for near-term healthcare expenses, we recommend allocating enough in your HSA money market to cover the current year's deductible. In all other cases, we recommend investing the bulk of the HSA assets in a growth-oriented strategy. Tapping your HSA isn't a last resort (we'd recommend doing so before, for example, taking on credit card debt), but it's a very costly option when you consider the forgone growth potential of each dollar taken out.

Where can I save for retirement?
With healthcare costs rising rapidly, it's becoming more important to save for healthcare costs in retirement. As we discussed in "Healthcare in retirement" (published 7 August 2017), we estimate that the average healthy 65-year-old couple will need to save USD 300,000–600,000 in order to fund their healthcare expenses in retirement.

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This estimate includes Medicare, supplemental insurance premiums, and most out-of-pocket healthcare costs in retirement, but does not account for long-term care (LTC) costs, which can be sizable and should be planned for separately. Consider that, according to a 2016 study, the median 65-year-old can expect to spend a total of USD 184,000 in lifetime LTC expenses, while roughly 25% of couples will spend more than USD 500,000 on LTC during their lifetime.

As we discussed above, HSAs are a crucial tool for funding healthcare expenses in the Longevity strategy because of their unique tax advantages. Because you may not be able to add to HSAs throughout your working life (you may want to shift to a low-deductible health plan when you're older and start a family), we recommend front-loading your contributions to contribute as much as possible earlier in your career, and leaving those assets invested until they are needed during retirement to make the most of HSAs' triple tax-free growth.

Retirement accounts, such as 401(k)s and IRAs, have much higher contribution limits, so even though they are only "double tax advantaged" they will likely represent the bulk of most investors' retirement assets, and thus a crucial component of the Longevity strategy.

When feasible, you should maximize your contributions to your 401(k)/IRA assets and to your HSA. If it's not feasible, the question shouldn't be about picking one account over the other, it should be about the prioritization of your savings contributions. This involves weighing your current tax rate, employer match, investment options, and the tax rate you'll face in retirement.

Do I need disability insurance?

If you're in your working years, one major asset that you might overlook on your balance sheet is "human capital," which represents the value of your future earnings potential. From your family's perspective, this a stream of income that they rely on for current living expenses and retirement savings, and it is the bulk of your net worth until you approach retirement (at which point you will have turned unearned income into financial assets).

In other words, when considering disability insurance, you're essentially deciding whether to insure your family's biggest asset. Consider, for example, what would happen if you were no longer able to earn an income due to disability. Who would pay your bills? Would your family find another way to fund their living expenses? If you aren't ever able to return to work, how will they fund all future expenses for their lifetimes?

Permanent—or even temporary—losses of human capital can wreak havoc on a family's financial situation. Disability insurance can be a powerful tool for protecting your family, and to ensure that your Longevity strategy will be large enough to provide for the future well-being of your family in the event that you're no longer able to work.

In order to assess whether or not you have the right disability coverage, it can be helpful to evaluate the gap between your coverage level and your family's expenses today. This comparison will allow you to measure whether or not the coverage is sufficient to meet your family's expenses and savings goals without your salary.

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If there is a large gap, consider supplementing your coverage, either through your employer—where it may be a voluntary benefit where you pay out-of-pocket for the premiums for a higher level of coverage at a group rate—or directly from an insurance company.

Do I need life insurance?

Life insurance can also be considered a part of the Longevity strategy—if you pass away during your working years, a life insurance payout can help fund your family's lifetime expenses—but it can also be an important tool for your Legacy strategy, funding inter-generational wealth transfers and philanthropic goals, for example.

Similar to disability insurance, some employers may pay a portion or all of your life insurance premiums for a standard level of coverage, but this may not be a large enough policy to assure your family's prosperity. If it isn't sufficient, you may be able to apply for supplemental coverage through your employer, or purchase another policy directly from an insurance company.

A proper insurance calculation can help you measure the present value dollar amount it would take to fully fund your family's daily living expenses for your survivors, as well as education expenses, or even the potential need for child care. But without a proper evaluation, it can be difficult to quantify just how much your family would need in the event you pass prematurely, meaning you might leave your human capital insufficiently protected.

Make sure you discuss your life insurance strategy with your financial advisor to make sure you manage any tax implications; there may be strategies to enhance the after-tax payout to your family—especially if your wealth could be subject to federal or state estate taxes.

In addition to life insurance, it's also crucial to make sure all workplace benefits, such as savings accounts and insurance policies, have accurate beneficiary information on file. This helps ensure your assets are transferred to your loved ones upon your passing.

Conclusion

This is not an exhaustive list of workplace benefits, but we hope that it helps give you a head start as you make your annual open enrollment elections.

Make sure you discuss these decisions with your financial advisor and tax consultant, where relevant, and consider them through the lens of your overall financial plan. After all, many of these choices require a balance between what's optimal for your financial situation today, versus what's best for you and your family in the future.

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Version 06/2019. CIO82652744

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