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Health Savings Accounts: Wave of the Future or Flavor of the Month?

Four years of double-digit health care cost increases have caused purchasers to hike co-pays and deductibles, reduce benefits, and rely on various other cost containment strategies. These approaches have proven largely ineffective, as costs continue to climb, so new ideas such as consumer-driven health plans continue to emerge.

Consumer-driven health plans aim to slow the growth in medical costs by giving consumers financial incentives and reliable information to support efficient health care decision-making.

Consumer-driven health plans include employee-designated and customized package plans, Health Reimbursement Arrangements (HRAs) and Flexible Spending Accounts (FSAs). This *FYI* focuses on the newest of consumer-driven health plans, *Health Savings Accounts (HSAs),* which became available in 2004.

What is an HSA?

Created as part of the Medicare Modernization Act of 2003, HSAs are tax-free savings accounts that can be used to pay for current or future medical expenses. An HSA is only available in conjunction with a *High Deductible Health Plan* (HDHP), which pays for major medical expenses. The HSA owner pays for qualified medical expenses from the HSA up to the amount of the HDHP's annual out-of-pocket deductible, which is at least $1,000 for individual coverage or $2,000 for family coverage. After the deductible is met, the HDHP begins paying for medical expenses, although the consumer may still be responsible for co-pays and coinsurance. In 2005, the maximum out-of-pocket cost for an HDHP (including the deductible, co-pays and coinsurance) is $5,100 for single coverage and $10,200 for family coverage. An HDHP can have first dollar coverage (no deductible) for preventive care such as annual physicals, immunizations and well-child care. There may be higher co-pays and co-insurance for out-of-network services.

The employer, the individual, or both can make contributions to the HSA, which is funded through the establishment of an outside trust/custodial account. For 2005, the maximum contribution is $2,650 for individual coverage ($5,250 for family coverage) or the amount of the HDHP deductible, whichever is less. Persons between the ages of 55 and 65 can make extra catch-up contributions.

Employees essentially own their HSAs and can keep their accounts if they switch employers. Unused funds can be carried over from one year to the next, and can be used for future medical expenses.

HSAs offer tax advantages. Contributions, earnings, and distributions for qualified medical expenses are federal income tax-free. In April 2005, the Pennsylvania State Senate unanimously approved a bill (SB 300) that would also allow HSA contributions and withdrawals to be exempt from state income taxes. The bill is pending in the House.

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To be eligible for an HSA, a person can not be covered by other health insurance, can not be eligible for Medicare, and cannot be claimed as a dependent on someone else's tax return. Couples filing jointly may have one HSA or two.

Money in an HSA can be used to pay for qualified medical expenses, i.e., those expenses that would be eligible for the medical and dental expense deduction. A complete list of qualified medical expenses can be found at http://www.irs.gov/publications/p502/index.html. Employers may choose to remove some of these items at their discretion. Qualified medical expenses include premiums for long-term care insurance, COBRA premiums, and health care insurance premiums while receiving unemployment compensation. For persons 65 and over, previously accumulated funds can be used for premiums for Medicare Parts A and B, Medicare HMOs, and the employee's share of retiree medical insurance premiums. Any non-eligible expenditure is subject to a 10% tax penalty.

Some Employers Begin Offering HSAs

While employers appear to have a modest interest in HSAs, only eight percent of surveyed organizations are currently offering HSAs, according to a 2005 Health/Watson Wyatt survey. Eighteen percent are *planning* to offer HSAs in 2006, and 47 percent are *considering* offering them. Many of these employers are putting employee education programs in place prior to implementation.

A few Pennsylvania employers – including Hershey Foods, Fulton Financial Corporation, PPL and Auntie Anne's – began offering HSAs in 2005. Some of these employers are making contributions to help employees grow their accounts.

Other employers have decided not to offer HSAs, perhaps because they believe the high-deductible health plans may be unpopular with workers or burden employees, particularly those with chronic conditions, with steep out-of-pocket expenses.

The Case for HSAs

Proponents say HSAs give consumers more choice, individual ownership, and greater control over their own health care. They believe consumers should be able to make complex decisions about their health care if given the right information and education. The theory is that informed consumers will create competition among providers, bringing down the cost of health care. Another premise is that if consumers must pay for their own health care, they will purchase care more carefully and incur fewer unnecessary costs, just as changes in prescription drug coverage have led some consumers to ask a physician to prescribe a generic drug instead of a newer, more expensive medication. There may also be a greater incentive for people to improve their health (for example, losing weight or stopping smoking) to avoid literally paying for the consequences of their unhealthy behaviors.

Small businesses -- which have been particularly hard-hit by rising health insurance costs -- could save money because HDHPs have lower premiums than first dollar coverage policies. Some small businesses have saved up to 42 percent on their health care costs through consumer-driven products, according to the National Federation of Independent Business (NFIB). But 47 percent of small businesses do not provide any health insurance coverage for themselves or their employees, and 60% of the uninsured either own or work for a small business. Proponents believe that some uninsured individuals and small business owners who previously could not afford to purchase health insurance may now be able to do so through HSAs and HDHPs. As an incentive to small, for-profit employers for contributions made to HSAs, the Bush Administration has proposed refundable tax credits to the employer.

Opposing Views

Opponents doubt that HSAs are a solution to rising health care costs. They caution that shifting responsibility for health care costs to consumers may

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adversely affect ability to pay and access to care.

The concept behind insurance is to pool together the risks of many individuals so that no one is unprotected in case of a catastrophic illness. Some fear that HSAs will attract the young, healthy and wealthy, while older and sicker employees who choose traditional plans may see their costs rise sharply. Ten percent of individuals account for 69 percent of health care costs, according to Karen Davis, President of the Commonwealth Fund.

According to a Commonwealth Fund report, lower income Americans will not have enough disposable income to save large amounts of money in their HSAs and will not be able to afford even HDHPs because the tax benefits for lower income persons are too small. Low-income families could spend up to 30 percent of their income under HDHPs, when out-of-pocket costs are included. President Bush has proposed giving eligible low-income families a $2,000 refundable tax credit to help purchase an HDHP, as well as a $1,000 direct contribution to their HSAs. Opponents of HSAs say that any tax savings will likely be offset by the loss of negotiated provider discounts on expenses charged to the individual before the deductible is reached.

Currently, it is very difficult to obtain price information directly from health care providers or insurers. This creates a significant barrier to consumers becoming informed shoppers for health care. According to a recent survey of 28 major insurers conducted by the health care consulting firm Reden & Anders, Ltd., 44 percent said they publish no information on patients' expected medical costs, and 56 percent publish no quality information. Of those publishing cost information, only 29 percent provide costs for specific services by named hospitals/physicians, while 52 percent give only average costs across the market. Contracts with health care providers often restrict insurers from disclosing detailed price information, according to Mohit Ghose, a spokesperson for America's Health Insurance Plans (*Medscape Medical News*, April 21, 2005).

One concern is that while employers may gain through transition to a fixed cost plan, employees will be at risk for health care inflation in cases where the employer contributes to the HSA, but then requires the employee to purchase the HDHP.

The element missing from consumer-driven health plans is a strategy that promotes high quality care, said Karen Davis. "Longer-term solutions aimed directly at the root causes of higher costs are needed to improve health care performance and to achieve better quality, safety and efficiency of care."

Summary

HSAs are a good idea in theory but must be predicated on consumers having reliable health care information. Pennsylvania leads the nation in delivering reliable consumer information, but even in Pennsylvania the scope of the existing data stream leaves consumers with inadequate information to make valid choices within an HSA framework. Until that vacuum is filled, informed consumer choice may be wishful thinking.

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