


Editor's Note:

CONEXIS
Jason Culp

In an effort to provide you with the most informative and beneficial content possible, we will soon begin introducing new features in the *CONEXIS Comment* newsletter. We are excited about the changes and we look forward to providing you with a “new and improved” *CONEXIS Comment*.

In conjunction with the launch of the new and improved *CONEXIS Comment* newsletter, we are transitioning to a quarterly publication schedule. The next issue of the *CONEXIS Comment* will be published in July, with subsequent issues to follow in October, January, and April.

We welcome any feedback you have regarding ways we can improve the *CONEXIS Comment*. Please drop us a line at comment@conexis.com with any comments or suggestions. 

Retiree Health Care Options Expand HSAs

Business Insurance
Jerry Geisel

Features that make it attractive for employers to offer health savings accounts (HSA) and health reimbursement arrangements (HRA) to employees also make them appealing as retiree health care funding vehicles, an expert says.

For employers who contribute to HSAs or HRAs, the costs are predictable; for employees, there are tax breaks such as tax-free accumulation of earnings and tax-free distributions taken to pay for health care expenses.

While neither arrangement will provide all that is needed to cover health care expenses after retirement, HSAs and HRAs are among the most tax-effective vehicles to accumulate savings, said Brad Kimler, executive VP with mutual fund giant Fidelity Investments.

Speaking last month at the 5th annual World Health Care Congress in Washington, Mr. Kimler said employers face a retiree health care coverage dilemma.

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On one hand, old-style retiree health care plans have become unaffordable and many employers have terminated the plans, which often extend coverage for younger retirees or supplement Medicare for older retirees. However, without employer-provided coverage, some employees may be unable to afford to retire and will stay on the job longer than either they or their employers would like, potentially blocking advancement of younger employees.

HRAs and HSAs can be an attractive middle ground between providing coverage that may prove unaffordable or offering no coverage at all.

“Employers are taking a step back...and looking at what is the most effective mechanism” to help fund retiree health care coverage, Mr. Kimler said.

Earlier this year, Ford Motor Co. put in place an HRA-linked program for nonunion retirees. For both pre-Medicare and Medicare-eligible retirees, Ford each year contributes \$1,800 per retiree, plus an additional \$1,800 for a retiree's spouse, to an HRA. In the case of pre-Medicare-eligible retirees, Ford continues to provide retiree health care plans, though its contribution is capped at what it paid in 2006 with future increases born by retirees.

Fidelity's HRA is designed differently. Under the program set up last year, Fidelity provides

employees with a \$3,000 annual credit in an HRA. Employees can draw from the account after turning 55 to pay for retiree health care expenses on a tax-free basis. Employees vest in the credits after 10 years of service.

Fidelity began to consider such a program based on employee surveys that found an overwhelming majority of employees said they didn't know how they would pay for retiree health care expenses.

HSAs also can be retiree health care funding vehicles. To the extent that employees haven't used accumulated contributions and investment earnings to pay for health care expenses while working, those funds will be available to pay retiree health care expenses on a tax-free basis.

HSAs “can be useful tools” for retiree savings, Mr. Kimler said.

Still, some employees probably won't conserve HSA assets to have funds available when they retire. Some may believe they don't have to save up for retiree health care expenses.

“Some people think Medicare covers everything. They don't budget for health care,” said Beth Bierbower, vp-innovation at

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Louisville, Ky.-based Humana Inc., who also spoke at the session.

At the same time, rapidly growing HSAs have been under congressional scrutiny.

Tax legislation passed last month by the House of Representatives requiring the substantiation of distributions from HSAs would increase paperwork and costs for enrollees and give them fewer choices in which to open and maintain their accounts, experts say.

Under the legislation, banks would have to report unsubstantiated distributions on tax forms, making HSA enrollees automatically subject to income taxes and, in certain cases, penalties.

To meet these requirements, HSA enrollees would have to fill out claims forms and provide receipts in many cases. Currently, HSA enrollees can take distributions with no questions asked as to their purpose.

Handling that paperwork “will impose a much higher cost structure” for banks, Mr. Kimler said.

Those higher costs will lead some smaller banks to exit the market and reduce competition for enrollees' accounts, Ms. Bierbower.

“We think that competition is healthy,” she said.

Both Ms. Bierbower and Mr. Kimler questioned the need for the substantiation requirement. Individuals now must report HSA distributions on an IRS tax form. As with other information reported on tax reforms, individuals who misstate the use of HSA distributions face penalties if their tax returns were audited and the IRS caught those misstatements, Ms. Bierbower said.

On the plus side, the White House has warned that President Bush would veto an HSA substantiation requirement, reducing the chances that the proposal will become law, at least in the near-term.

Amid that legislative development, HSAs continue to grow. A survey released last week by America's Health Insurance Plans said enrollment in high-deductible health insurance plans linked to HSAs leaped 35% last year to 6.1 million.

Additionally, an earlier survey by Mercer L.L.C. found that 9% of employers with at least 500 employees offered HSAs in 2007, up from 6% in 2006, while the 6% of employers offered an HRA program both years. 🏹

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High Deductible Plans Report Rapid Growth

Business Insurance

Jerry Geisel

Enrollment in high deductible health insurance plans linked to health savings accounts (HSA) continues to surge, with the plans rapidly becoming a mainstream benefit plan offering.

As of Jan. 1, 2008, 6.1 million people were enrolled in HSA-linked health insurance plans, a 35% increase over Jan. 1, 2007, according to an America's Health Insurance Plans census released last week.

Enrollment in the plans shot up across all markets, according to AHIP, with the biggest percentage increase in the small-employer market. Employers with 50 or fewer employees had 1.8 million people in HSA-linked plans, roughly a 70% increase over the previous year.

Enrollment also increased sharply in other markets. In the large-employer market, employers with at least 51 employees, enrollment in HSA-linked plans increased to 2.8 million, up about 35%, while enrollment in the individual market climbed to 1.5 million, also about a 35% increase.

Enrollment has been growing "at a very consistent and strong pace," said AHIP President and Chief Executive Officer Karen Ignagni in Washington.

Enrollment increases have been at such a high level that the plans no longer are niche products but are now a part of the mainstream health care benefit plan market, said Jeff Munn, a principal and consultant in the Falls Church, Va., office of Hewitt Associates Inc.

HSAs, authorized under a 2003 federal law that added a prescription drug benefit to the Medicare program, first became available on Jan. 1, 2004, and enrollment has been surging ever since. For example, earlier AHIP surveys reported HSA enrollment at 1 million in March 2005, 3.2 million as of Jan. 1, 2006, and 4.5 million as of Jan. 1, 2007.

AHIP said it believes its annual census covers virtually all people enrolled in health insurance plans linked to HSAs.

A key reason for the big enrollment increase is that premiums for high deductible health insurance plans linked to HSAs are much lower than more traditional health insurance plans, where member cost-sharing is much less.

For example, as of Jan. 1, the average annual premium for family coverage provided

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through the best-selling HSA-linked HDHP in the large group market was \$8,241, according to the AHIP survey. That compares with an average premium of \$12,106 for employer-sponsored family coverage last year, according to a Kaiser Family Foundation survey.

Benefit experts say enrollment growth is coming from two sources: employers that are offering HSA-linked plans for the first time and in existing plans where positive employee experience is leading other employees to sign up.

“The early enrollees are kind of like poster children. They talk to other employees. That is becoming a powerful influence,” said Jay Garriss, national director-HSA client relationship management at Affiliated Computer Services Inc. in Raleigh, N.C.

Additionally, the one factor that turned many employees away from HSAs, the exposure to high health care costs through the linked high deductible health insurance plan, has become much less of a negative as employee cost-sharing in more traditional health plans has climbed.

“The high deductible is not so high anymore,” Mr. Garriss said.

Under law, the HDHP linked to an HSA must have a deductible no lower than \$1,100 for individual coverage and \$2,200 for family coverage.

Another big appeal of HSA-based plans is tax breaks that are not available for other plan designs. Employee contributions to HSAs are made on a pre-tax basis, can be indefinitely rolled over, earn tax-free interest and are distributed on a tax-free basis to pay for covered health care expenses.

By contrast, while employee contributions, for example, to flexible spending accounts also are pre-tax and distributions are tax-free, account balances are forfeited either at the end of the year, or if an employer adopts a so-called grace period FSA, unused account balances can be used to pay claims incurred during the first two-and-a-half months of the following plan year.

Still, it will be some time before HDHPs linked to HSAs become the dominant health care plan design. Many employees, Hewitt Associates' Mr. Munn notes, remain reluctant to accept the trade-off inherent with the plans: a lower premium but exposure to claims costs that may not be predictable.

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Employees reason that they would “rather have predictability than a lower premium and the potential for a major out of pocket expense,” Mr. Munn said.

And the one action that employers could take that would supercharge growth of the plans is a step few are willing to take: making the plans the only plan design they offer.

“Employers are sensitive to the need to offer choice,” said Brad Kimler, an executive VP with Fidelity Investments in Boston.

Future growth also could be affected by how much support the arrangements receive from federal lawmakers. Until recently, lawmakers have increased the appeal of the arrangements through various legislative initiatives.

For example, legislation passed in 2006 effectively allows employees to make significantly higher contributions to HSAs than they could have under prior law. The legislation also allows employees to make the maximum contribution allowed under law, regardless of when during the year they became eligible to contribute to an HSA. Previously, HSA contributions had to be prorated to reflect when an employee became eligible for coverage.

Lately, though, the political climate has become chillier. Last month, the House of Representatives passed a tax bill with a provision that would require banks in which enrollees have established HSAs to substantiate that HSA distributions were for health care expenses.

That would result in employees having to save and file receipts along with claims forms, substantially increasing administrative overhead and forcing banks to increase charges and perhaps resulting in some pulling out from the HSA market, experts have said.

If the political climate continues to deteriorate, that could hurt future growth. “How much the market continues to grow will depend at least in part on the prevailing political climate,” Mr. Munn said. 🔥

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Health / Employee Benefits: Stacked Health Plans

Best's Review

Ripperger, Jerry L.

What's Up: New legislation gives employers more options in consumer-driven health care plans.

What's Happening: Health benefits are being "stacked" together to create hybrids.

What's Next: Plan advisers should help clients communicate these new benefits to workers.

Interest in consumer-driven health care has exploded in the past five years, thanks to favorable legislation and regulation, new products and services and the promise of slowing escalating health care costs.

Previously, employers, with the assistance of financial professionals, generally had to choose between health reimbursement arrangements (HRA), health savings accounts (HSA) or health flexible spending accounts (FSA).

The Tax Relief and Health Care Act of 2006 provided employers with much more flexibility and the opportunity to take the best of these consumer-driven health care options and pull them together. Referred to as "stacked plans" these hybrids are starting to gain employer attention.

A stacked plan allows an employer to include an HSA, an HRA and a limited FSA in the same benefit design. For example, the employer purchases a qualified, high deductible health plan (HDHP) with a \$2,500 deductible for each

employee. The policy offers first-dollar coverage for preventive care, meaning the member pays only a small or no copay.

This component is essential to the consumer-driven model because it encourages members to seek preventive care, such as annual physicals, to identify health concerns before they become more costly.

Next, the employer provides a \$500 HRA benefit that offers coverage after the member has paid the first \$1,100 toward the deductible. If the member uses the full benefit, then that person only pays the remaining \$900 to satisfy the deductible. If the HRA goes unused or partially used, the employer can choose to have these funds roll over to build funds for the member to use in future years.

The combination of the plans qualifies as an HSA-compatible plan because the deductible of \$1,100 meets the statutory minimum for 2008. Eligible members can establish HSAs and contribute up to \$2,900 to their accounts. Depending on how much an employer is contributing, members may be able to contribute more to the HSA than they will spend in a given year, allowing them to roll over the funds for future years. A similar

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approach holds true for those with family coverage except the minimum deductible would differ.

The ability to fully fund the account has piqued interest in these arrangements. Prior to the Tax Relief and Health Care Act of 2006, funding was limited to the lesser of the deductible or the statutory limit. The act removed this provision and allows for full funding, regardless of the qualified HDHP deductible.

In addition, the same employer can offer a limited-purpose health care flexible spending account that allows for reimbursement of dental and vision expenses--a convenient, tax-advantaged method to fund for expenses such as orthodontics treatment and laser eye surgery.

There are significant advantages to both the employer and employee with this benefit design. Employers obtain a substantial number of ways to control the cost of their benefit programs. They can directly influence their employees' health care activities through thoughtful design that encourages preventive care.

With the help of their adviser, the employer can set the following:

- The HDHP deductible limit, coinsurance and out-of-pocket limits
- The HRA benefit amount, and deductible prior to the account paying benefits
- Charges covered by the HRA

- If/how the HRA rolls over to future years
- What happens to unused HRA funds upon eligibility termination

Employees benefit from the stacked design, too, especially the lower premium contributions typically required for the HDHP and the HRA benefit provided by the employer. If the HRA allows for rollover, they can reduce their potential liability going forward simply by making good health and health care choices.

Employees also enjoy the tax savings that HSAs and limited-purpose FSAs create. Employees determine how much money to contribute to their HSAs and how to use the funds. (Taxes and penalties may apply if used for non-qualified expenses).

The role of the agent or broker in helping design these programs is critical, but it doesn't end at plan design. Employers need the help of their advisers to communicate the new benefits to employees, and to educate them on how to get the most out of their health plan.

Communication must be a cornerstone of these programs, and should be done frequently and in multiple formats. In addition, employers should consider holding educational meetings at nontraditional times such as evenings, so that spouses can attend.

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The stacked design focuses the employer's attention on the HRA, the consumer-driven health care option that provides the greatest flexibility and control for employer funding. Employees will focus on the HSA, the CDHC option that gives them the greatest control and flexibility over how they use their own money.

The new legislation goes a long way toward merging the best features of consumer-driven health care, both for employers and employees.

Consumer-Driven Health Plans Defined

FSA: Flexible Spending Accounts: These accounts are reimbursement arrangements by employers to allow employees to pay their group health insurance premium contribution with tax-free dollars.

HRA: Health Reimbursement Arrangement: This type of account is established, funded and maintained by employers to cover eligible medical expenses not covered under the employer's health plan. It works in conjunction with a high-deductible health plan (HDHP), generally provided by the employer, which covers major health expenses.

HSA: Health Savings Accounts: These are tax-advantaged trust or custodial accounts created for the benefit of individuals covered under a qualified HDHP. 

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Comment Newsletter



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