Health Savings Accounts: A New Approach to Control Rising Health Insurance Premiums

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Health Savings Accounts (HSAs) are a hot topic in the employee benefits arena, as employers of all sizes look for ways to control the relentless rise of health insurance costs. HSAs fall under the category of “Consumer-Directed” healthcare plans, which are designed to involve the consumer more in the financing and decision-making process related to the use of healthcare services. Figure 1 shows the average increase in health insurance premiums, workers’ earnings, and overall inflation from 1988 through 2005. In recent years, health insurance premiums have exceeded the rise in workers’ earnings and overall inflation by a wide margin.¹

Employers of all sizes are scrambling to find a health insurance model that will lower the annual increase of health insurance premiums. Employers are moving away from tightly managed health maintenance organizations (HMOs) due to rising costs for comprehensive first-dollar paid benefits and employee desire to choose providers when healthcare services are needed. This has resulted in preferred provider organizations (PPOs) becoming the dominant form of health plan design in the United States.² PPOs allow greater choice of providers for healthcare services but lack the cost controls that most HMOs provide for expensive services in the areas of utilization control and case management.

The Establishment and Growth of HSAs
HSAs came into existence through Title XII of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. This provision authorized the establishment of HSAs starting January 1, 2004. HSAs combine a qualified high deductible health plan design with a savings and investment vehicle that allows both individuals and employers to make tax-deductible contributions to the HSA. Funds in the HSA accumulate tax-free and when qualified expenses are paid from the HSA, the individual account owner does not pay taxes on the distribution. Tax professionals refer to the unique tax advantages of the HSA as the “triple crown” of taxation (defined as tax-free contributions, tax-free earnings accumulation, and tax-free disbursement).

HSA investment options are similar to those available for IRA and 401(k) plans. Figure 2 (page 24) provides an illustration of how the two necessary components of an HSA work to provide high deductible, catastrophic health insurance and a savings/investment vehicle to pay for health expenses authorized for payment under IRS Section 213d. Common allowable expenses include plan deductibles, coinsurance and healthcare services that may not be covered under the health insurance plan. IRS permits a few additional HSA-eligible expenses beyond the scope of Section 213d, which include payment for long term care insurance, COBRA, and Medicare premiums. These additional expense provisions are intended to provide HSA account owners with additional flexibility in spending HSA balances on a tax-free basis.

Since inception in January 2004, HSAs have experienced explosive growth. In a study published by America’s Health Insurance Plans, HSAs crossed the one million covered lives mark in March 2005.³ What’s even more noteworthy is that this growth represents a doubling of coverage in a six-month period from September 2004. As a result of rapid enrollment growth, HSAs are increasingly becoming an employee health insurance option. To encourage employee selection of an HSA, employers will typically require employees to pay significantly

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³ Number of HSA Plans Exceeded One Million in March 2005, America’s Health Insurance Plans; www.ahip.org
less for premiums than for traditional health insurance plans and will often contribute a fixed dollar amount to the employee's HSA. Unlike Health Reimbursement Arrangements (HRAs) that came into existence in 2002, HSAs are controlled and owned by the employee. All sources of fund contributions (from employee or employer) are owned by the employee.4

**HSA Plan Design is Unique and Structured by Law**

Title XII of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established mandates for HSA plan design. These mandates have resulted in common elements that must be part of every qualified high deductible health plan. Key plan design elements required by Title XII include:

- **Deductibles**—for 2006, the minimum deductible allowable is $1,050 for single coverage and $2,100 for family coverage. (Minimum deductible amounts are indexed annually for inflation.)

- **Combined deductible and coinsurance maximum**—for 2006, these amounts combined cannot exceed $5,250 for single coverage and $10,500 for family coverage. (Combined deductible and coinsurance maximums are indexed annually for inflation.)

- **Elimination of fixed dollar copays before deductible is met**—Fixed dollar copays for physician and emergency services are not allowed before the plan deductible is satisfied, although physician and emergency services are covered plan benefits that are subject to the deductible and applicable coinsurance.

- **Prescription drug benefits**—most prescription drugs must be subject to the medical plan deductible before benefits are paid. This is a huge change for most plans. It will also have a significant impact on plan members, who are used to prescription drug benefits being paid on a first-dollar basis without any linkage to the medical plan deductible. By linking prescription drug benefits to the underlying medical plan deductible, most first-dollar prescription drug payments are not permitted for HSA plans.

- **Wellness benefits**—This provision allows annual physicals and specified health screenings to be covered by the plan at 100% before the deductible is applied to encourage individuals to seek routine physicals and health screenings. (Note that a handful of prescription drugs fall under this category, but many health insurance plans do not cover these drugs under the first-dollar wellness benefit program.)

**Who are Good Candidates for HSAs?**

I've had the opportunity since early 2004 to meet with over 100 employers ranging in size from the sole proprietor to the Fortune 500 to discuss HSA plans in detail. What I've discovered are common elements that indicate whether an employer should consider introduction of an HSA to its workforce. Figure 3 lists factors to consider before choosing an HSA. Answering in the affirmative to most of these statements indicates that the organization is positioned to gain employee acceptance for an HSA offering.5

**Communication is Critical for HSA Success**

Organizations that embark on the HSA path must commit to intense, ongoing employee communications to ensure understanding of the HSA plan's numerous complexities. Effective communication is required to foster employee understanding and acceptance of the HSA plan. There are two complex topics for employees to understand with HSAs. The first involves the unique HSA health insurance plan design requirements that result in the HSA being much different from traditional health insurance plans in several key areas. The second involves explanation of how the HSA savings/investment vehicle works. The employer will also need to choose a trustee (typically a bank or mutual fund company) to handle the deposit and investment of HSA funds. A Visa or MasterCard debit card is typically used for employee access to HSA funds for payment of qualified medical expenses. Like a 401(k) plan, the employee account owner is responsible for choosing the appropriate investment options for HSA funds.

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5 Statements developed by Jeff S. Rubleski, MBA, based on in-depth interviews with health insurance plan sponsors.

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Due to the complexities of HSAs, most employers should consider introducing an HSA with an existing health plan option to give employees a choice of plan design. This will allow the “early adopters” to try the HSA and give the organization time to assess the impact of the HSA on employee satisfaction and cost savings. Since the high deductible plan design should result in significant premium savings, participants should be rewarded through lower premium contributions and fixed or matching employer contributions to their HSA. These positive financial incentives should encourage voluntary employee HSA plan participation.

Will HSAs Lower Healthcare Costs?
Proponents of HSAs believe that when consumers spend their first dollars for healthcare (from their HSA), consumers will be more prudent in their management of medical expenses. This anticipated consumer involvement is expected to produce lower medical cost and better quality outcomes. Proponents also believe that HSA account owners will demand more “transparency” in quality and pricing for medical services, resulting in price reductions and quality enhancements for needed medical services.6

Critics of HSAs point out that the plan design of HSAs does little to help those who need healthcare the most. Critics argue that HSAs represent a significant cost shift of health insurance payment responsibility from the employer to the employee. Critics charge that the financial benefits of HSAs will accrue mainly to the healthiest and wealthiest employees and that older and less financially secure employees will bear a disproportionate financial and emotional burden under the high deductible plan design requirements of an HSA.

What Does the Future Hold?
Nobody knows for sure whether HSAs will deliver anticipated cost savings and improvement in healthcare outcomes. At a minimum, HSAs will allow employers to shift more healthcare financing responsibility to employees through higher deductibles and the availability of tax-advantaged HSA savings/investments accounts. It will take a few years of actuarial study to determine whether HSAs will have a significant impact on health insurance premium increases. With healthcare costs representing an ever-growing percentage of every organization’s operating budget, the current system of health insurance financing and use of medical services must go through comprehensive change for most businesses to remain competitive in a global economy. Business leaders must be prepared to embrace radical change in the financing and delivery of health insurance benefits to remain competitive in the years ahead. Moving forward, it does appear that businesses of all sizes will look to their employees to assume more financial and personal responsibility to help solve the challenge of ever-rising health insurance premiums. With more consumer financial and personal involvement in healthcare decision-making, perhaps HSAs will prove to be a sustainable health insurance model that will give businesses the ability to control future increases in health insurance premiums. Only time will show whether HSAs will deliver anticipated cost-saving results.

Good Candidates for HSAs

- Employees have access to the Internet for researching health benefit options.
- Employees typically are not covered by a collective bargaining agreement.
- Employees pay significant percent of health insurance premium.
- In-network deductibles and member coinsurance payments are in current plan design.
- Average employee receives competitive compensation.
- Company promotes an active culture of employee wellness.
- Company has a Section 125 plan in place.
- Company demographics are favorable.
- Company plans to make a fixed contribution or a matching contribution to the employee’s HSA account.

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